Supreme Court, U.S.
FILED
JUN 17 2004

No. 031672

In The

Supreme Court Of The United States

DEPARTMENT OF SOCIAL SERVICES OF THE STATE OF CONNECTICUT

Petitioner

v.

NEAL OSSEN, Trustee

Respondent

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED FOR REVIEW

1. Whether, pursuant to 11 U.S.C. § 106(c), a state agency that files a proof of claim against a bankruptcy debtor can be deemed to waive its Eleventh Amendment immunity to a claim of setoff by the debtor when the claim of setoff does not arise out of the same transaction or occurrence as the agency's claim.

2. Whether, pursuant to 11 U.S.C. § 106(c), the filing of a proof of claim against a bankruptcy debtor by one state agency waives the Eleventh Amendment immunity of all state agencies.

LIST OF ALL PARTIES TO THE PROCEEDING

The parties to the proceeding before the United States Court of Appeals for the Second Circuit, which is the court whose judgment is sought to be reviewed, were Neal Ossen, Trustee (plaintiff-appellee) and the Department of Social Services of the State of Connecticut (defendant-appellant).

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IN THE
SUPREME COURT OF THE UNITED STATES
OCTOBER TERM, 2003

DEPARTMENT OF SOCIAL SERVICES OF THE STATE OF CONNECTICUT

Petitioner

v.

NEAL OSSEN, Trustee

Respondent

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

The Petitioner, the Connecticut Department of Social Services, respectfully prays that this Court issue a writ of certiorari to review the decision of the United States Court of Appeals for the Second Circuit entered in this case on March 19, 2004.

CITATIONS TO OPINIONS BELOW

The opinion of the United States Court of Appeals for the Second Circuit is reported at *Ossen v. Department of Social Services (In re Charter Oak Assocs.)*, 361 F.3d 760 (2d Cir. 2004), and is reprinted in the Appendix hereto at App. 2A.

The memorandum of decision of the United States District Court for the District of Connecticut, *Ossen v. Department of Social Services (In re Charter Oak Assocs.)*, Civil Action No. 3:97CV16 (AWT) (D. Conn. Sept. 30,

2002), is unreported and reprinted in the Appendix hereto at App. 21A.

The memorandum of decision of the United States Bankruptcy Court for the District of Connecticut is reported at *Ossen v. Department of Social Services (In re Charter Oak Assocs.)*, 203 B.R. 17 (Bankr. D. Conn. 1996). The decision is reprinted in the Appendix hereto at App. 33A.

JURISDICTIONAL STATEMENT

The judgment of the United States Court of Appeals for the Second Circuit was entered on March 19, 2004. This Court has jurisdiction over this petition pursuant to 28 U.S.C. § 1254(1).

CONSTITUTIONAL PROVISIONS AND STATUTES INVOLVED IN THE CASE

The Eleventh Amendment to the United States Constitution:

> The Judicial power of the United States shall not be construed to extend to any suit in law or equity, commenced or prosecuted against one of the United States by Citizens of another State, or by Citizens or Subjects or any Foreign State.

Section 106 of the U.S. Bankruptcy Code (11 U.S.C. § 106):

> Section 106. Waiver of sovereign immunity
>
> (a) Notwithstanding an assertion of sovereign immunity, sovereign immunity is abrogated as to a governmental unit to the extent set forth in this section with respect to the following:

(1) Sections 105, 106, 107, 108, 303, 346, 362, 363, 364, 365, 366, 502, 503, 505, 506, 510, 522, 523, 524, 525, 542, 543, 544, 545, 546, 547, 548, 549, 550, 551, 552, 553, 722, 724, 726, 728, 744, 749, 764, 901, 922, 926, 928, 929, 944, 1107, 1141, 1142, 1143, 1146, 1201, 1203, 1205, 1206, 1227, 1231, 1301, 1303, 1305, and 1327 of this title.

(2) The court may hear and determine any issue arising with respect to the application of such sections to governmental units.

(3) The court may issue against a governmental unit an order, process, or judgment under such sections or the Federal Rules of Bankruptcy Procedure, including an order or judgment awarding a money recovery, but not including an award of punitive damages. Such order or judgment for costs or fees under this title or the Federal Rules of Bankruptcy Procedure against any governmental unit shall be consistent with the provisions and limitations of section 2412(d)(2)(A) of title 28.

(4) The enforcement of any such order, process, or judgment against any governmental unit shall be consistent with appropriate nonbankruptcy law applicable to such governmental unit and, in the case of a money judgment against the United States, shall be paid as if it is a judgment rendered by a district court of the United States.

(5) Nothing in this section shall create any substantive claim for relief or cause of action not otherwise existing under

this title, the Federal Rules of Bankruptcy Procedure, or nonbankruptcy law.

(b) A governmental unit that has filed a proof of claim in the case is deemed to have waived sovereign immunity with respect to a claim against such governmental unit that is property of the estate and that arose out of the same transaction or occurrence out of which the claim of such governmental unit arose.

(c) Notwithstanding any assertion of sovereign immunity by a governmental unit, there shall be offset against a claim or interest of a governmental unit any claim against such governmental unit that is property of the estate.

Section 101(27) of the U.S. Bankruptcy Code (11 U.S.C. § 101(27)):

Section 101. Definitions.

* * *

(27) "governmental unit" means United States; State; Commonwealth; District; Territory; municipality; foreign state; department, agency, or instrumentality of the United States (but not a United States trustee while serving as a trustee in a case under this title), a State, a Commonwealth, a District, a Territory, a municipality, or a foreign state; or other foreign or domestic government.

STATEMENT OF THE CASE

This case arises out of a Chapter 7 bankruptcy proceeding and raises recurring questions of vital importance to all states concerning the scope of the waiver of sovereign immunity that can be constitutionally imposed when a state agency files a proof of claim against a bankruptcy debtor's estate. The Bankruptcy Court had jurisdiction over this matter based on 28 U.S.C. §§ 157 and 1334.

Prior to 1991, the debtor, Charter Oak Associates, Inc. ("Charter Oak"), operated group homes for state-supported mentally disabled persons. (App. at 3A). As a group home operator, Charter Oak received reimbursements under state law from the petitioner, Connecticut Department of Social Services ("DSS"), for expenses incurred in providing its services. *See* Conn. Gen. Stat. § 17a-228. On June 30, 1991, Charter Oak ceased to operate its group homes and, on December 5, 1991, filed a Chapter 7 bankruptcy petition in the United States Bankruptcy Court for the District of Connecticut. (App. at 3A).

On March 27, 1992, the Connecticut Department of Revenue Services ("DRS"), which is not a party to this case, filed a proof of claim in the amount of $148,643.34 for Connecticut use taxes that Charter Oak had failed to pay on certain purchases in connection with the operation of its group home facilities. (App. at 3A). DSS did not file a proof of claim.

In May, 1996, the bankruptcy trustee, Neal Ossen ("Trustee"), filed an adversary proceeding against DSS in the Bankruptcy Court. (App. at 4A). The Trustee alleged that DSS had performed an audit of Charter Oak in 1992 and 1993 and concluded that Charter Oak was entitled to $225,309.29 in additional reimbursements from DSS. (App.

at 4A). Because DSS had not paid the additional reimbursements, the Trustee sought either an order of turnover or a judgment in the amount of $225,309.29. (App. at 4A). Although the reimbursements sought by the Trustee were unrelated to the purchases on which Charter Oak had failed to pay use taxes, the Trustee claimed that, pursuant to 11 U.S.C. § 106, the filing by DRS of a proof of claim in the bankruptcy proceedings for unpaid use taxes resulted in a waiver of DSS's Eleventh Amendment immunity with regard to the Trustee's claim for reimbursement. (App. at 4A, 37A).

On July 15, 1996, DSS filed a motion to dismiss the adversary proceeding filed by the Trustee. In support of its motion, DSS argued that (1) 11 U.S.C. § 106(a), which purports to abrogate the states' Eleventh Amendment immunity in bankruptcy proceedings, is unconstitutional; and (2) the fact that DRS filed a proof of claim did not waive DSS' Eleventh Amendment immunity pursuant to 11 U.S.C. §§ 106(b) or (c).

The Bankruptcy Court denied the motion to dismiss. Although the court agreed with DSS that (1) 11 U.S.C. § 106(a) is unconstitutional because Congress lacks the authority to abrogate Eleventh Amendment immunity in the bankruptcy context; and (2) Charter Oak's claim did not fall within the ambit of 11 U.S.C. § 106(b) because it did not arise out of the same transaction or occurrence as DRS's claim, the Bankruptcy Court concluded that the Trustee could proceed under 11 U.S.C. § 106(c). (App. at 4A, 47A). According to the Bankruptcy Court, the filing of a proof of claim by DRS waived DSS' Eleventh Amendment immunity because both agencies constitute a single "governmental unit" for purposes of 11 U.S.C. § 106(c). (App. at 42A-44A).

On December 12, 1996, DSS appealed to the United States District Court for the District of Connecticut, which affirmed the Bankruptcy Court's decision on September 30, 2002. (App. at 21A). On November 1, 2002, DSS filed a notice of appeal with regard to the District Court's construction of 11 U.S.C. § 106(c). The Trustee did not cross-appeal the Court's rulings concerning 11 U.S.C. §§ 106 (a) and 106(b).

On March 19, 2004, the United States Court of Appeals for the Second Circuit affirmed the ruling of the District Court. (App. at 2A). In so doing, the Second Circuit noted that although the constitutionality of 11 U.S.C. § 106(a) was not before it, some discussion of Eleventh Amendment immunity and § 106(a) was necessary in order to understand its construction of § 106(c). (App. at 5A-6A)

With regard to § 106(a), the Second Circuit observed that almost all Circuits that have considered the issue have concluded that the purported abrogation of Eleventh Amendment immunity set forth in § 106(a) is unconstitutional because the Bankruptcy Clause of Article I of the U.S. Constitution, pursuant to which § 106(a) was enacted, does not grant Congress the authority to abrogate the states' Eleventh Amendment immunity.[1] (App. at 7A). The Second Circuit reasoned that "[i]f Congress does not have the power to abrogate state sovereign immunity pursuant to its powers under the Bankruptcy Clause, then presumably it also lacks power to enact a bankruptcy provision that defines a waiver of immunity that is broader in scope than would be permitted under the Eleventh

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[1] This issue was before this Court recently in *Tennessee Student Assistance Corporation v. Hood*, __ U.S. __, 124 S. Ct. 1905 (2004). This Court resolved the case on other grounds, however, and did not reach the issue whether § 106(a) is an unconstitutional abrogation of Eleventh Amendment immunity.

Amendment." (App. at 9A). Applying this presumption to the waiver of sovereign immunity set forth in 11 U.S.C. § 106(c), the Second Circuit explained that "[i]f § 106(c) expands either the circumstance or the scope of a state's waiver beyond what would be permitted by the Eleventh Amendment, it is an abrogation of state sovereign immunity and may, therefore, be constitutionally suspect." (App. at 10A).

Turning to § 106(c), the Second Circuit stated that this Court has long held that a state that files a proof of claim in a bankruptcy case thereby waives its Eleventh Amendment immunity as to the adjudication of that claim. (App. at 11A). Undecided by this Court, however, is whether such a waiver extends beyond the consideration of objections to the state's proof of claim. (App. at 12A). Although the Second Circuit acknowledged that the Fourth Circuit has concluded that the Eleventh Amendment only permits compulsory counterclaims, namely those claims that arise out of the same transaction or occurrence as the state's claim, to be asserted against a state, the Second Circuit rejected the Fourth Circuit's conclusion. (App. at 15a-16A). Citing equitable considerations purportedly drawn from *Lapides v. Board of Regents of the University System*, 535 U.S. 613 (2002), the Second Circuit concluded that "the Eleventh Amendment permits the assertion by a debtor of permissive counterclaims that are capped by a setoff limitation against a state that has filed a proof of claim." (App. at 15A). Finding that this was the scope of the waiver set forth in § 106(c), the Second Circuit concluded that the provision was constitutional.

The Second Circuit further concluded that the filing of a proof of claim by one state agency acts as a waiver of immunity as to every other state agency because the agencies are considered the same "governmental unit" for purposes of 11 U.S.C. § 106(c). Reasoning that "where the

two agencies in question act as a unitary creditor, fairness . . . demands that a waiver by one be deemed to extend to the other," the Second Circuit held that DRS and DSS were the same governmental unit and therefore, pursuant to 11 U.S.C. § 106(c), the Trustee could "seek from DSS so much of the reimbursement it is owed as will offset the estate's debt to DRS for unpaid taxes." (App. at 20A). The Second Circuit therefore affirmed the District Court's ruling denying DSS's motion to dismiss.

REASONS FOR GRANTING THE WRIT

This case raises two important and recurring questions concerning the scope of the waiver of Eleventh Amendment immunity that results pursuant to 11 U.S.C. § 106(c)[2] when a state agency files a proof of claim against a bankrupt debtor's estate: (1) whether, by filing a proof of claim, a state agency waives its Eleventh Amendment immunity to claims by the debtor that do not arise out of the same transaction or occurrence; and (2) whether such a filing by one state agency waives the Eleventh Amendment immunity of all state agencies with regard to the debtor's claims. By answering both questions in the affirmative, the Second Circuit has created a conflict among the Circuits with regard to the first issue and resolved the second issue in a manner that conflicts with the majority of the lower courts that have addressed the question. Moreover, with regard to both issues, the Second Circuit's ruling flies in the face of established principles governing the waiver of Eleventh Amendment immunity and decides an issue of vital importance to all states in a manner that is extremely detrimental to the states' ability to enforce their laws. Because it is essential to all states to conclusively resolve

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[2] 11 U.S.C § 106(c) provides that "[n]otwithstanding any assertion of sovereign immunity by a governmental unit, there shall be offset against a claim or interest of a governmental unit any claim against such governmental unit that is property of the estate."

this important and unsettled area of federal law, certiorari is warranted.[3]

I. THE SECOND CIRCUIT'S CONCLUSION THAT THE FILING OF A PROOF OF CLAIM WAIVES A STATE'S IMMUNITY WITH RESPECT TO A DEBTOR'S CLAIM THAT DID NOT ARISE OUT OF THE SAME TRANSACTION OR OCCURRENCE AS THE STATE'S CLAIM IS IN DIRECT CONFLICT WITH ESTABLISHED PRINCIPLES GOVERNING THE WAIVER OF ELEVENTH AMENDMENT IMMUNITY AND WITH THE DECISIONS OF OTHER CIRCUIT COURTS OF APPEAL.

According to the Second Circuit, "when a state files a proof of claim in a bankruptcy case, it waives its [Eleventh Amendment] immunity with respect to . . . claims of the debtor's estate **that did not arise out of the same transaction or occurrence**, to the extent that they offset the state's claim." (App. 9A, emphasis added). This

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[3] This case is not within the Court's recent ruling in *Tennessee Student Assistance Corporation v. Hood*, __ U.S.__, 124 S.Ct. 1905 (2004). In that case, the Court found that issues regarding the viability of the student loan hardship exception were within the *in rem* jurisdiction of the bankruptcy court to afford the debtor a discharge. The issue here, to the contrary, is a direct effort to litigate a monetary recovery against the state. This is precisely the sort of issue that the Court indicated in *Hood* could be distinguished from its ruling there. *Id.* 124 S.Ct at 1912. Moreover, the suit for monetary recovery asserted by the debtor here is the same sort of action that this Court reviewed in *Hoffman v. Connecticut Dept. of Income Maintenance,* 492 U.S. 96 (1989), and *U.S. v. Nordic Village,* 503 U.S. 30 (1992). In both cases, the Court found that the actions were barred by the Eleventh Amendment and sovereign immunity, respectively, after concluding that Congress had not effectively attempted to abrogate that immunity. Had these actions not been subject to governmental immunity to begin with, the scope of the statute would have been irrelevant. The issue here is to what extent, if any, there has been a waiver of that existing immunity by virtue of a claims filing.

conclusion fundamentally misconstrues the permissible scope of the waiver of Eleventh Amendment immunity that results from filing a proof of claim and conflicts with the rulings of other United States Courts of Appeal.

As this Court has long held, the Eleventh Amendment to the United States Constitution renders nonconsenting states and their agencies immune from suits brought by private parties in federal court. *Seminole Tribe of Florida v. Florida*, 517 U.S. 44, 54 (1996); *Florida Department of State v. Treasure Salvors, Inc.*, 458 U.S. 670, 684 (1982). Such immunity constitutes a jurisdictional limitation on the power of all federal courts, including bankruptcy courts. *Hoffman v. Connecticut Department of Income Maintenance*, 492 U.S. 96 (1989); *Seminole Tribe*, 517 U.S. at 73 n. 16.

The only exceptions to Eleventh Amendment immunity are if (1) a state waives its immunity and consents to suit in federal court, *Atascadero State Hospital v. Scanlon*, 473 U.S. 234, 238 (1985); or (2) Congress abrogates a state's immunity by unequivocally expressing its intent to do so and acting pursuant to a valid exercise of power. *Seminole Tribe*, 517 U.S. at 55. A state waives its Eleventh Amendment immunity "if [it] voluntarily invokes [a federal court's] jurisdiction, or . . . if [it] makes a 'clear declaration' that it intends to submit itself to [a federal court's] jurisdiction." *College Savings Bank v. Florida Prepaid Postsecondary Educational Expense Board*, 527 U.S. 666, 675-676 (1999)(internal citation omitted). As a rule, "a waiver of sovereign immunity is to be strictly construed, in terms of its scope, in favor of the sovereign." *Department of the Army v. Blue Fox, Inc.*, 525 U.S. 255, 261 (1999).

This Court addressed waiver in the bankruptcy context in *Gardner v. New Jersey*, 329 U.S. 565 (1947), in

which the State of New Jersey filed a proof of claim for unpaid taxes against a debtor's estate and the debtor responded by filing objections to the claim. This Court concluded that "[w]hen the State becomes the actor and files a claim against a fund it waives any immunity which it otherwise might have had **respecting the adjudication of the claim**." *Id.* at 574, emphasis added. According to the Court, by invoking the jurisdiction of the Bankruptcy Court by filing a proof of claim, a state waives its immunity as to "the whole process of proof, allowance, and distribution" of that claim. *Id.* at 574. This does not mean, however, that a state thereby opens itself up to any and all claims against it. On the contrary, *Gardner* stands only for the proposition that the filing of a proof of claim waives immunity as to the adjudication of the state's claim.[4]

Those Circuits Courts that have considered whether the waiver of immunity that results from filing a proof of claim may extend beyond the bounds of *Gardner* have, until the Second Circuit's ruling in this case, construed such waiver to extend, at most, to claims that arise from the same transaction or occurrence as the state's claim. *See, e.g., Arecibo Community Health v. Commonwealth of Puerto Rico*, 270 F.3d 17 (1st Cir. 2001); *Schulman v. California (In re Lazar)*, 237 F.3d 967, 978 (9th Cir. 2001); *Schlossberg v. Maryland (In re Creative Goldsmiths)*, 119 F. 3d 1140 (4th Cir. 1997).

Indeed, three Circuits, the Seventh Circuit, the Sixth Circuit and the Fourth Circuit, have explicitly rejected the contention that a state's filing of a proof of claim waives its

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[4] Indeed, there were no counterclaims at all in *Gardner*, and the Court there did not address the question of waiver as to counterclaims. *Gardner*, therefore, only stands for the unexceptional proposition that, when one invokes federal jurisdiction, one must allow the defendant party to assert its defenses.

immunity with regard to claims that do not arise out of the same transaction or occurrence. Specifically, in *Jones v. Yorke* (*In re Friendship Medical Center, Ltd.),* 710 F.2d 1297 (7th Cir. 1983), the Seventh Circuit considered whether the Illinois Department of Public Aid ("IDPA"), by filing a proof of claim against a bankrupt medical center, had waived its immunity as to any unrelated claim against it arising from its dealings with the debtor. In concluding that it had not, the court relied on the fact that *Gardner* "establish[ed] that the limited waiver of sovereign immunity created by the filing of the [proof of] claim extends only so far as necessary to adjudicate that claim, such as considering the objections of other parties to the claim." *Id.* at 1301. The court further relied on the fact that in the "closely related area of federal sovereign immunity," "[w]aiver does not extend to what federal procedure terms 'permissive' counterclaims, . . . claims for affirmative relief in excess of or different in kind from that sought by the plaintiff." *Id.* at 1301, quoting *Federal Savings & Loan Insurance Corp. v. Quinn*, 419 F.2d 1014, 1017 (7th Cir. 1969). Because the plaintiffs' claim against IDPA was completely unrelated to the subject of the proof of claim IDPA filed against the bankrupt medical center, the court concluded that the plaintiff's claim against IDPA was barred by sovereign immunity.

Similarly, in *State of Ohio v. Madeline Marie Nursing Homes No. 1 and 2*, 694 F.2d 449, 462 (6th Cir. 1982), the court held that a state's filing of a proof of claim did not constitute a waiver with respect to the debtor's turnover claim that did not arise from the same transaction or occurrence as the state's proof of claim.

The Fourth Circuit addressed a similar issue in *Schlossberg v. Maryland* (*In re Creative Goldsmiths)*, 119 F. 3d 1140 (4th Cir. 1997). It considered whether a proof of claim filed by the State of Maryland to recover sales and

withholding taxes from a Chapter 7 debtor waived the state's immunity with regard to the trustee's suit to avoid, as a preference, income taxes paid to the state by the debtor within 90 days of the filing of the bankruptcy petition. The court concluded that, as a general rule, the scope of a state's waiver of immunity by filing a proof of claim is limited to compulsory counterclaims. It found that, in the case before it, the trustee's action did "not arise out of the same transaction or occurrence supporting Maryland's proof of claim." *Id.* at 1149. Accordingly, the court dismissed the trustee's suit, concluding that it was barred by sovereign immunity.

Although the Second Circuit acknowledged the Fourth Circuit's ruling in *Schlossberg*, it rejected it. Relying on the "waiver-by-litigation" principle set forth in *Lapides v. Bd. of Regents of the Univ. System*, 535 U.S. 613 (2002), which holds that a state is deemed to have invoked the court's jurisdiction when it makes a voluntary appearance in federal court, the Second Circuit concluded that concerns with fairness and consistency supported the conclusion that a state that files a proof of claim thereby waives its Eleventh Amendment immunity with regard to the debtor's counterclaims, even if the counterclaims do not arise out of the same transaction or occurrence as the proof of claim.

In so holding, however, the Second Circuit improperly expanded the scope of the waiver-by-litigation doctrine set forth in *Lapides* in a manner that is wholly inconsistent with this Court's view that waivers of Eleventh Amendment immunity must be strictly construed. *See Department of the Army v. Blue Fox, Inc.*, 525 U.S. 255, 261 (1999). Specifically, the Second Circuit failed to acknowledge the distinction between *Lapides*, in which the state removed a case from state to federal court, thereby voluntarily invoking the federal court's jurisdiction to

adjudicate the plaintiff's claims, and the present case, in which the state filed a proof of claim in a proceeding that was already in federal court, thereby doing nothing to voluntarily invoke the federal court's jurisdiction. By concluding that the state's filing not only invoked the federal court's jurisdiction, but did so with regard to claims arising out of transactions and occurrences that are wholly unrelated to the state's proof of claim (and, unlike a removal action, may not even involve a federal issue), the Second Circuit misconstrued *Lapides* and erroneously and improperly expanded the waiver-by-litigation doctrine.[5]

The Second Circuit not only misconstrued *Lapides*, but also failed to recognize the impact of its misconstruction. In its decision, the Second Circuit stated that it could "see no reason why a state that has filed a proof of claim in a bankruptcy case should be permitted to raise the immunity shield in response to permissive counterclaims brought by the debtor, at least where those counterclaims are capped by a setoff limitation," because "the state will never be liable to pay anything." (App. at 14A). This reasoning, however, totally ignores the fact that denying a state the full recovery of its claim by permitting a setoff has the same practical effect as permitting a recovery against the state. In both cases, the debtor gains financially at the expense of the state treasury. To conclude, as the Second Circuit has done, that the state is financially unaffected by such a result is patently incorrect.

Indeed, the Second Circuit's opinion is not only analytically flawed, but will, if allowed to stand, have an extremely detrimental effect on the finances of state governments across the country. If the filing of a proof of

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[5] The court's expansive view of the waiver set forth in § 106(c) is also inconsistent with this Court's earlier view of § 106(c) [previously codified as § 106(b)] as a "narrow waiver." *Hoffman v. Connecticut Department of Income Maintenance*, 492 U.S. 96, 102 (1989).

claim in a bankruptcy proceeding opens the door to any claim that the debtor may have against the state, no matter how unrelated to the subject of the state's claim, states will be forced to expend considerable sums to defend themselves in countless legal proceedings in federal courts throughout the country concerning disputed issues that are entirely unrelated to the state's proof of claim. In order to avoid subjecting themselves to such suits and the panoply of legal proceedings that will accompany them, states will be forced to consider abandoning their statutory obligations to enforce their tax, consumer fraud, Medicaid and environmental laws against delinquent debtors through the filing of proofs of claim, thereby compounding the negative impact on state treasuries. Because such a result would be wholly inconsistent with the purpose of the Eleventh Amendment to protect state sovereignty, certiorari is warranted to uphold the sovereignty of the states and to resolve the conflict between the states on this important issue.

II. THE QUESTION WHETHER THE FILING OF A PROOF OF CLAIM BY ONE STATE AGENCY OPERATES AS A WAIVER OF ELEVENTH AMENDMENT IMMUNITY AS TO ALL STATE AGENCIES IS A MATTER OF VITAL IMPORTANCE TO ALL STATES THAT WAS ERRONEOUSLY DECIDED BY THE SECOND CIRCUIT AND SHOULD BE RESOLVED BY THIS COURT.

Certiorari is further warranted because, in construing the term "governmental unit" in § 106(c) to encompass all state agencies, such that a proof of claim filed by one state agency waives the sovereign immunity of all state agencies, the Second Circuit has erroneously decided a question of federal law of vital importance to all

states that has not been, but should be, settled by this Court.[6]

A. The Second Circuit Failed To Construe 11 U.S.C. § 106(c) In Accordance With Established Rules Of Statutory Construction.

In construing 11 U.S.C. § 106(c), the Second Circuit failed to recognize that the most important factor to consider in construing a statute is the language of the statute itself. *Hartford Underwriters v. Union Planters Bank, N.A.*, 530 U.S. 1, 6 (2000). For purposes of § 106(c), the Bankruptcy Code defines the term "governmental unit" as "United States; State; Commonwealth; District; Territory; municipality; foreign state; department, agency, or instrumentality of the United States . . . , a State, a Commonwealth, a District, a Territory, a municipality, or a foreign state; or other foreign or domestic government." 11 U.S.C. § 101(27). A close review of the punctuation indicates that the Code includes three main categories: (1) the United States, states, localities and so forth; (2) a department, agency or instrumentality of the entities in number 1; and (3) a catchall provision for any other foreign or domestic government.

The Bankruptcy Code thus separately identifies both a state and a department, agency, or instrumentality of a state as governmental units. Nowhere is there any suggestion that, for purposes of Eleventh Amendment immunity, when a state agency acts it does so on behalf of all state agencies. Instead, the implication of the Bankruptcy Code's definition of governmental unit is that a

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[6] The Second Circuit relied almost exclusively on cases that consider the meaning of the term "governmental unit" for purposes of general setoff rights. (App. at 18A-19A). Such cases, however, do not involve Eleventh Amendment immunity and thus are inapposite to the issue in the present case.

state agency can and will act only for itself. If this were not the case, the references to department, agency or instrumentality would be mere surplusage. Because a court should give effect, if possible, to every word in a statute, such a construction is unacceptable. *Duncan v. Walker*, 533 U.S. 167, 174 (2001).

Additionally, a construction that automatically equates a state agency with a state for § 106 purposes cannot be squared with the language of § 106 itself. Section 106(c) specifically states that "there shall be offset against a claim or interest of a governmental unit any claim against ***such*** governmental unit." 11 U.S.C. § 106(c)(emphasis added). In other words, the offset is limited to the specific governmental unit making the claim against the debtor's estate. This means that, in the present case, because it was DRS that filed a proof of claim against the debtor, the debtor could offset the proof of claim with any claim it had against DRS, but not with a claim against a separate agency such as DSS.[7] This is the conclusion reached by a majority of lower courts that have addressed the meaning of "governmental unit" in connection with § 106. *See, e.g., William Ross, Inc. v. Biehn Construction, Inc. (In re Ross)*, 199 B.R. 551, 556 (Bankr. W.D. Pa. 1996)(based on "the plain language of 11 U.S.C. § 101(27), which defines 'governmental unit'" for purposes of § 106 (c), tax claims by two Pennsylvania state agencies against debtor did not waive immunity of Pennsylvania Department of General Services); *Bezner v. East Jersey State Prison (In re Exact Temp, Inc.)*, 231 B.R. 566, 571 (Bankr. D.N.J. 1999)(proofs of claim filed by the Department of Transportation and the Department of Labor did not waive the immunity of the state prison because, for purposes of § 106, "immunity is waived only with respect

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[7] Of course, as discussed in section I, *supra*, any claim asserted against DRS would have to arise out of the same transaction or occurrence as the proof of claim asserted against the debtor.

to [the] agency that files a proof of claim"); *Sacred Heart Hospital v. Department of Public Welfare* (*In re Sacred Heart Hosp. of Norristown)*, 204 B.R. 132, 142 (E.D. Pa. 1997), *aff'd*, 133 F. 3d 237 (3d Cir. 1998)(proofs of claim filed by Department of Labor and Department of Revenue did not waive immunity of Department of Welfare); *Unicare Homes, Inc v. Four Seasons Care Centers, Inc.* (*In re Four Seasons Care Centers, Inc.*), 119 B.R. 681 (Bankr. D. Minn. 1990)(proof of claim filed by Minnesota Department of Revenue Services did not waive immunity of Minnesota Department of Human Services).

To conclude otherwise, as the Second Circuit has done, and permit one state agency to waive the Eleventh Amendment immunity of another state agency not only defies basic rules of statutory construction, but also flies in the face of all rules governing waiver. As discussed above, this Court has consistently held that waivers of sovereign immunity must be clear and unequivocal and strictly construed in favor of the sovereign. *Department of the Army v. Blue Fox, Inc.*, 525 U.S. 255, 261 (1999). In the present case, the language of § 106 and the definition of "governmental unit" do not clearly and unequivocally direct that all state agencies be treated as a unified governmental unit. Indeed, the rules of statutory construction yield the opposite result. In the absence of a clear and unequivocal declaration by Congress that a waiver by one state agency is a waiver for all, the Second Circuit should have adopted the narrower interpretation.

Furthermore, to the extent that the Second Circuit based its decision on an analogy to cases treating the United States as a unitary creditor for purposes of asserting setoff and determining immunity issues, the court ignored two essential points. First, the United States has already chosen to **waive** its immunity from suit by enacting § 106. Although the United States may waive its own immunity, it

may act only act on the states' immunity by way of abrogation. Second, (perhaps because it has chosen to waive its immunity), the United States has affirmatively and unequivocally **chosen** to request that it be treated as a unitary creditor for all purposes. *See Doe v. United States*, 58 F. 3d 494 (9th Cir. 1995). Because the Second Circuit can point to no similar voluntary and unequivocal choice by the State of Connecticut, its conclusion that Connecticut should likewise be treated as a unitary creditor is clearly erroneous.

B. The Second Circuit's Opinion, If Allowed To Stand, Will Impose A Significant Administrative And Fiscal Burden On State Governments.

As a practical matter, the Second Circuit's conclusion that a waiver by one state agency is a waiver for all state agencies imposes a tremendous administrative burden on states and, like the conclusion that such a waiver applies regardless of whether the claims arise from the same transaction or occurrence, will have an extremely detrimental effect on the ability of states to enforce their laws and recover claims from debtors in bankruptcy.

If a state agency elects to submit itself to the jurisdiction of the Bankruptcy Court by filing a proof of claim, it does so with the knowledge that the debtor may assert certain claims or setoffs against it. An individual state agency can make that judgment after weighing the rights, claims and defenses it has against the debtor and that the debtor has against it. In the modern administrative state, however, it cannot be reasonably assumed that a single state agency can make that judgment as to all state agencies. With the vast array of potential obligations, contracts, and other relationships that any one debtor might have with different state agencies, it would be exceedingly burdensome and unrealistic to expect one state agency to be

capable of knowingly waiving Eleventh Amendment immunity for claims that could be asserted against all other state agencies. This is particularly true where the government is often an involuntary creditor (as with taxes or environmental claims) and may often not even initially be aware of all of the claims that it may hold against a debtor.

Moreover, this is not merely a matter of administrative inconvenience. As discussed above in section I, the exceedingly broad interpretation of waiver adopted by the Second Circuit means that a state agency, knowing that by filing a proof of claim it may unleash a barrage of suits against other, unsuspecting state agencies, may hesitate to file a claim. Unlike the simplicity of submitting a one page proof of claim that is prepared by a low-level employee and often concerns an undisputed obligation, defending against a claim of setoff may involve complicated legal issues and require the state agency's participation in the full panoply of coercive legal proceedings, including the need for counsel, formal pleadings, discovery, briefs, and contested hearings. Further the state agency forced to defend itself, possibly in a distant jurisdiction, may have nothing to do with the bankruptcy proceeding and may, in fact, have deliberately chosen not to file its own claim in order to avoid such expensive and time consuming litigation. The result will be that state agencies will hesitate to enforce state laws, including tax, consumer fraud, health, and environmental laws, against delinquent debtors, thereby negatively impacting state treasuries and, ultimately state taxpayers.

The issue is further complicated by the fact that unlike a department or agent of a private corporate entity, state agencies take independent actions, within the scope of their lawful authority, in a variety of common contexts. State agencies can, and often do, act on diverse, and even

adverse, interests. Indeed, the adversity of interests of state agencies can result in litigation among such agencies. *See Connecticut Commission on Special Revenue v. Connecticut Freedom of Information Commission*, 174 Conn. 308, 387 A.2d 533 (1978); *Administrator, Unemployment Compensation Act v. Moffett*, 60 Conn. App. 746, 760 A.2d 1277 (2000). Whereas it may be in the interest of one agency to file a proof of claim, it may be very much to the detriment of another agency that would unknowingly be stripped of its immunity. To conclude under these circumstances, as the Second Circuit has done, that one state agency can waive the immunity of all others, at least in the absence of an unequivocally clear statement that this is what Congress intended in enacting § 106(c) or that the state government *chose* to be treated for all purposes as a unitary creditor, defies the basic principles underlying Eleventh Amendment immunity and its waiver.

Accordingly, given the importance to all states of determining the scope of the waiver of Eleventh Amendment immunity that results pursuant to 11 U.S.C. § 106(c) when a state or one of its agencies files a proof of claim in a bankruptcy proceeding, and the conflicting positions taken on the issue in the lower courts, this Court's review of the Second Circuit's decision is essential in order to clarify and resolve this important and unsettled question of federal law.

CONCLUSION

For all of the foregoing reasons, the petitioner respectfully submits that this Petition should be granted and a writ of certiorari should issue to review the judgment and opinion of the United States Court of Appeals for the Second Circuit.

Respectfully submitted,

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No. _____

In The

Supreme Court Of The United States

DEPARTMENT OF SOCIAL SERVICES OF THE STATE OF CONNECTICUT

Petitioner

v.

NEAL OSSEN, Trustee

Respondent

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

APPENDIX

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UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

August Term 2003

(Argues November 14, 2003 Decided March 19, 2004)

Docket No. 02-5068

In re: CHARTER OAK ASSOCIATES,
Debtor.

NEAL OSSEN, Trustee,
Plaintiff-Appellee,
-- v. –

DEPARTMENT OF SOCIAL SERVICES,
State of Connecticut,
Defendant-Appellant

Before: WALKER, Chief Judge, LEVAL and CABRANES, Circuit Judges.

Appeal from a judgment of the United States District Court for the District of Connecticut (Alvin W. Thompson, Judge) denying defendant-appellant's motion to dismiss an adversary proceeding on the ground of sovereign immunity.

AFFIRMED.

MARK F. KOHLER, Assistant Attorney General (Richard Blumenthal, Attorney General for the State of Connecticut, on the brief), Hartford, CT, for Defendant-Appellant.

G. ERIC BRUNSTAD, JR., Bingham McCutchen, LLP (Rheba Rutkowski, Susan Kim, Tanya Tymchenko, Melissa G. Liazos, on the brief), Hartford, CT, for Plaintiff-Appellee.

JOHN M. WALKER, JR., Chief Judge:

Section 106 of the Bankruptcy Code purports to abrogate state sovereign immunity under certain circumstances in the bankruptcy context, *see* 11 U.S.C. § 106(a), and, in the absence of abrogation, to define circumstances under which a state will be deemed to have waived its immunity, *see* 11 U.S.C. §§ 106(b) and (c). In this case, we must decide whether a state agency's assertion of sovereign immunity precludes the adjudication under § 106 (c) of a claim asserted by a bankruptcy trustee against that agency to offset recovery by another agency of the same state against the bankrupt estate.

BACKGROUND

For several years prior to 1991, Charter Oak Associates, Inc. ("Charter Oak") operated leased residential facilities for state-supported individuals with mental disabilities. On or about June 30, 1991, the company ceased its operations and, in December of that year, filed a Chapter 7 petition in the United States Bankruptcy Court for the District of Connecticut (Robert L. Krechevsky, Bankruptcy Judge). On March 27, 1992, the Connecticut Department of Revenue Services ("DRS") filed a proof of claim against Charter Oak's estate for unpaid use taxes in the amount of $148,643.34.

After an audit conducted in 1992 and 1993, defendant-appellant Connecticut Department of Social Services ("DSS") determined that it owed Charter Oak $225,309.29 in rental reimbursements. Plaintiff-appellee Neil Ossen, the bankruptcy trustee, then commenced an adversary proceeding against DSS in the bankruptcy court, seeking the amount of the withheld reimbursements either by an order or turnover pursuant to 11 U.S.C. §542(b) or through a judgment. DSS moved to dismiss the complaint for lack of subject matter jurisdiction on the basis that, even though DRS had filed a proof of claim, the trustee's suit was barred by the Eleventh Amendment.[1]

The bankruptcy court denied the motion to dismiss. It agreed with DSS that § 106(a) was unconstitutional because Congress did not have the power to abrogate sovereign immunity in the bankruptcy context, and that the claim against DSS did not fall within the ambit of § 106(b). However, the bankruptcy court concluded that the trustee's claim could proceed under § 106(c). *See Ossen v. Connecticut (In re Charter Oak Assocs.),* 203 B.R. 17, 24 (Bankr. D. Conn. 1996). DSS filed an interlocutory appeal in the United States District Court for the District of Connecticut (Alvin W. Thompson, *Judge),* s*ee P.R. Aqueduct & Sewer Auth. v. Metcalf & Eddy, Inc.*, 506 U.S. 139, 147, 113 S. Ct 684, 121 L.Ed.2d 605 (1993) (denial of sovereign immunity is immediately appealable under collateral order doctrine), and the district court affirmed. Reviewing the district court's decision on this pure question of law *de novo, see In re Bell*, 225 F.3d 203, 209 (2nd Cir. 2000), now affirm.

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[1] DSS and DRS are both agencies of the state of Connecticut and thus immune form suit to the same extent as the state itself. *See Fla. Dep't of State v. Treasure Salvors, Inc.*, 458 U.S. 670, 684, 102 S. Ct 3304, 73 L.Ed.2d 1057 (1982) (sovereign immunity extends to state agencies).

DISCUSSION

Section 106 of the Bankruptcy Code reads in pertinent part as follows:

> (a) Notwithstanding an assertion of sovereign immunity, sovereign immunity is abrogated as to a governmental unit to the extent set forth in this section with respect to [several enumerated bankruptcy provisions including 11 U.S.C. §542] . . . .
>
> (b) A governmental unit that has filed a proof of claim in [a bankruptcy] case is deemed to have waived sovereign immunity with respect to a claim against such governmental unit that is property of the estate and that arose out of the same transaction or occurrence out of which the claim of such governmental unit arose.
>
> (c) Notwithstanding any assertion of sovereign immunity by a governmental unit, there shall be offset against a claim or interest of a governmental unit any claim against such governmental unit that is property of the estate.

11 U.S.C. §106.

The narrow issue before us is whether the district court erred in holding that the trustee could, consistent with the Eleventh Amendment and the language of § 106(c), assert Charter Oak's claim against DSS to offset the state of Connecticut's tax claim against the bankrupt estate. We need not (and do not) decide whether § 106(a) constitutes a valid abrogation of state sovereign immunity (a question currently pending before the Supreme Court, *see Tenn. Student Assistance Corp. v. Hood*, ___ U.S. ___, 124 S. Ct. 45, 156 L.Ed.2d 703 (2003) (Mem) (granting certiorari)) or whether the trustee's claim meets requirements of

§ 106(b).[2] However, some discussion of Eleventh Amendment immunity generally and of § 106(a) in particular is necessary to understand how, and in what circumstances, § 106(c) applies.

I. The Eleventh Amendment, Abrogation, and § 106(a)

The Eleventh Amendment provides:

> The Judicial power of the United States shall not be construed to extend to any suit in law or equity, commenced or prosecuted against one of the United States by Citizens of another State, or by Citizens or subjects of any Foreign State.

U.S. Const. amend. XI. "Although the text of the Amendment would appear to restrict only the Article III diversity jurisdiction of the federal courts," it has been construed more broadly to render states and their agencies immune from suits brought by private parties in federal court. *Seminole Tribe of Fla. v. Florida*, 517 U.S. 44, 54, 116 S. Ct. 1114, 134 L.Ed.2d 252 (1996); s*ee Fla. Dep't of State v. Treasure Salvors, Inc.*, 458 U.S. 670, 684, 102 S. Ct. 3304, 73 L.Ed.2d 1057 (1982) (sovereign immunity extends to state agencies). The doctrine of state sovereign immunity is the product of two principles underlying our constitutional framework: "first, that each State is a sovereign entity in our federal system; and second, that it is inherent in the nature of sovereignty not to be amenable to the suit of an individual without its consent." *Seminole Tribe*, 517 U.S. at 54, 116 S.Ct. 114 (internal quotation

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[2] The trustee did not appeal the bankruptcy court's rulings concerning §§ 106(a) and (b) because interlocutory orders favoring an invocation of sovereign immunity are not immediately appealable. *See LaTrieste Rest. & Cabaret v. Vill. of Port Chester*, 96 F.3d 598, 599-600 (2d Cir. 1996).

marks and punctuation omitted). State sovereign immunity is not just a "personal privilege" of the state, *see Coll. Sav. Bank v. Fla. Prepaid Postsecondary Educ. Expense Bd.*, 527 U.S. 666, 675, 119 S.Ct. 2219, 144 L.Ed2d 605 (1999), but also a jurisdictional limitation on the power of federal courts. The Eleventh Amendment effectively places suits by private parties against states outside the ambit of Article III of the constitution. *See Seminole Tribe*, 517 U.S. at 54, 116 S.Ct. at 1114.

State sovereign immunity is not absolute, however. It is subject to two qualifications. First, Congress can abrogate a state's immunity if it unequivocally expresses its intent to do so and acts "pursuant to a valid exercise of power." *See id.* at 55, 116 S.Ct. 1114 (internal quotation marks omitted). Second, a state can waive its immunity from suit. *See, e.g., Lapides v. Bd. Of Regents of the Univ. Sys.*, 535 U.S. 613, 618, 122 S.Ct. 1640, 152 L.Ed.2d 806 (2002); *Coll. Sav. Bank*, 527 U.S. at 675, 119 S.Ct. 2219.

Section 106(a) of the Code undertakes to effectuate the first kind of limitation; it purports to abrogate a state's immunity to certain bankruptcy suits. *See* 11 U.S.C. § 106(a). Most of our sister circuits, however, have concluded that this abrogation is constitutionally infirm. *See, e.g., Nelson v. La Crosse County Dist. Attorney*, 301 F.3d 820, 832 (7th Cir. 2002); *Mitchell v. Franchise Tax Bd. (In re Mitchell)*, 209 F.3d 1111, 1121 (9th Cir. 2000); *Sacred Heart Hosp. v. Pennsylvania (In re Sacred Heart Hosp.)*, 133 F.3d 237, 245 (3d Cir. 1998); *Dep't of Trans. & Dev. v. PNL Asset Mgmt. Co. (In re Estate of Fernandez)*, 130 F.3d 1138, 1139 (5th Cir. 1997) (per curiam) ("*Fernandez II*"), amending 123 F.3d 241 (5th Cir. 1997) ("*Fernandez I*"); *Schlossberg v. Maryland (In re Creative Goldsmiths)*, 119 F.3d 1140, 1145 (4th Cir. 1997). *But see Hood v. Tenn. Student Assistance corp. (In re Hood)*, 319 F.3d 755, 767-68 (6th Cir.) (holding that § 106(a) is constitutional), *cert. granted, Tenn. Student*

Assistance Corp. v. Hood, __ U.S. __, 124 S. Ct. 45, 156 L.Ed.2d 703 (2003) (Mem). These rulings are generally to the effect that § 106(a) fails the second prong of the abrogation test; although Congress obviously intended to abrogate state sovereign immunity when it enacted § 106(a), these circuits have held that it did not act pursuant to a "valid exercise of power" in carrying out that intent. Section 106(a) is an exercise of Congress's powers under the Bankruptcy Clause of Article I of the Constitution. *See Mitchell*, 209 F.3d at 1119; *Sacred Heart Hosp.*, 133 F.3d at 244-45; *Fernandez I*, 123 F.3d at 245; Schlossberg, 119 F.3d at 1146-47. Although the Supreme Court has yet to address squarely whether the Bankruptcy Clause provides a legitimate basis for abrogation, *cf. Tenn. Student Assistance Corp.*, __U.S.__,124 S. Ct. 45, 156 L.Ed.2d 703, the Court's precedents have uniformly rejected attempts to abrogate pursuant to other Article I powers. *See Fed. Mar. Comm'n v. S.C. State Ports Auth.*, 535 U.S. 743, 749-50, 122 S.Ct. 1864, 152 L.Ed.2d 962 (2002)("Congress, pursuant to its Article I powers, cannot abrogate state sovereign immunity . . . ."); *Bd. Of Trustees v. Garrett*, 531 U.S. 356, 364, 121 S.Ct. 955, 148 L.Ed.2d 866 (2001) (Congress may not, of course, base its abrogation of the States' Eleventh Amendment immunity upon the powers enumerated in Article I."); *Kimel v. Fla. Bd. Of Regents*, 528 U.S. 62, 78, 120 S.Ct. 631, 145 L.Ed.2d 522 (2000) ("Congress lacks power under Article I to abrogate the States' sovereign immunity."); *Fla. Prepaid Postsecondary Educ. Expense Bd. v. Coll. Sav. Bank*, 527 U.S. 627, 636, 119 S.Ct. 2199, 144 L.Ed.2d 575 (1999)(holding that Congress could not abrogate state sovereign immunity pursuant to the Patent Clause of Article I); *Seminole Tribe*, 517 U.S. at 65, 72, 116 S.Ct. 1114 (holding that Fourteenth Amendment is the only recognized source of authority for abrogation). In other words, there is some doubt about whether the Bankruptcy Clause, pursuant to which

Congress enacted § 106(a), gives Congress any power to abrogate state sovereign immunity.

Our analysis does not turn, ultimately, on whether § 106(a) passes constitutional muster, and we do not decide that issue. However, the doubts courts have raised about § 106(a)'s constitutionality spill over into the question of whether § 106(c) provides a valid basis for the trustee's suit against DSS. As explained below, if Congress does not have the power to abrogate state sovereign immunity pursuant to its powers under the Bankruptcy Clause, then presumably it also lacks power to enact a bankruptcy provision that defines a waiver of immunity that is broader in scope than would be permitted under the Eleventh Amendment.

II. Waiver and § 106(c)

In addition to abrogating state sovereign immunity in some circumstances, § 106 stipulates other circumstances in which a state will be deemed to have waived its immunity to certain types of claims as a result of its conduct in litigation. *See* 11 U.S.C. §§ 106(b) & (c). Under Congress's scheme, when a state files a proof of claim in a bankruptcy case, it waives its immunity with respect to: (1) claims of the debtor's estate "that arose out of the same transaction or occurrence out of which" the state's proof of claim arose, 11 U.S.C. § 106(b); and (2) claims of the debtor's estate that did not arise out of the same transaction or occurrence, to the extent that they offset the state's claim, 11 U.S.C. 106(c).

DSS argues that § 106(c) extends the scope of a state's waiver too far because, under the Eleventh Amendment, a state's filing of a proof of claim can be construed *at most* as a waiver of immunity with respect to claims that arose out of the same transaction or occurrence as the state's proof of claim. Therefore, in DSS's view,

§ 106(c) is unconstitutional. DSS also argues that, even if it passes constitutional muster, § 106(c) does not apply to this case. We consider each argument in turn.

a. Constitutionality of § 106(c)

Because the doctrine of waiver (as it pertains to state sovereign immunity) is rooted in and determined by the Eleventh Amendment itself, it cannot be extended by congress. *See, e.g., Coll. Sav. Bank*, 527 U.S. at 679-80, 119 S.Ct. 2219. Accordingly, § 106(c) is valid only if (1) it provides for (or "deems") a waiver of sovereign immunity in circumstances where the Eleventh Amendment would permit an inference of waiver, and (2) the scope of the waiver it describes comports with constitutional limitations. If § 106(c) expands either the circumstances or the scope of a state's waiver beyond what would be permitted by the Eleventh Amendment, it is an abrogation of state sovereign immunity and may, therefore, be constitutionally suspect – for the same reasons that § 106(a) may be constitutionally suspect.

The Fourth Circuit has suggested that Congress has no power to deem a waiver at all because that would be tantamount to abrogation. *See Schlossberg*, 119 F.3d at 1147 ("While 11 U.S.C. § 106(b) may correctly describe those actions that, as a matter of constitutional law, constitute a state's waiver of the Eleventh Amendment, it is nevertheless not within Congress' power to abrogate such immunity by 'deeming' a waver."). We disagree. If the "deemed" waiver is just a codification of constitutional waiver principles, it does not abrogate Eleventh Amendment immunity and is, therefore, constitutionally permissible.

In seeking to delineate the Eleventh Amendment boundaries of waiver, the Supreme Court has held that a state waives it immunity "either if [it] voluntarily invokes [a federal court's] jurisdiction, or else if [it] makes a 'clear declaration' that it intends to submit itself to [a federal

court's] jurisdiction." *Coll. Sav. Bank*, 527 U.S. at 675-76, 119 S.Ct. 2219 (internal citation omitted). Because application of § 106(c) to a particular case does not turn on the state's declared intent, but rather on the state's conduct, the section can only be constitutionally valid if it is a proper codification of the rule that voluntary invocation of a court's jurisdiction amounts to a waiver of sovereign immunity.

A state is deemed to have invoked the court's jurisdiction when it has made a "voluntary appearance in federal court." *Lapides*, 535 U.S. at 619, 122 S.Ct. 1640; *Gunter v. Atl. Coast Line R.R.*, 200 U.S. 273, 284, 26 S.Ct. 252, 50 L.Ed. 477 (1906)("[W]here a State voluntarily become[s] a party to a cause, and submits its rights for judicial determination, it will be bound thereby, and cannot escape the result of its own voluntary act by invoking the prohibitions of the [Eleventh] Amendment."). The doctrine of waiver by litigation, which derives directly from the Eleventh Amendment, is founded "not upon a State's actual preference or desire," but rather upon "the judicial need to avoid inconsistency, anomaly, and unfairness." *Lapides*, 535 U.S. at 620, 122 S.Ct. 1640; *see generally Jonathan R. Siegel, Waivers of State Sovereign Immunity and the Ideology of the Eleventh Amendment*, 52 Duke L.J. 1167 (2003) [hereinafter Siegel, *Waivers*].

One practical application of the waiver-by-litigation doctrine is the long-standing rule that a state waives its sovereign immunity by filing a proof of claim in a bankruptcy case. *See Gardner v. New Jersey*, 329 U.S. 565, 573-74, 67 S.Ct. 467, 91 L.Ed. 504 (1947); *see also Coll. Sav. Bank*, 527 U.S. at 681 n.3, 199 S.Ct. 2219 (re-affirming *Gardner*); *Lapides*, 535 U.S. at 619, 122 S.Ct. 1640 (same). In *Gardner*, the state of New Jersey filed a proof of claim for unpaid taxes and interest in the amount of approximately $20 million against the debtor's estate. 329 U.S. at 570, 67 S.Ct. 467. The trustee and the debtor

responded by filing objections to the claim, arguing, *inter alia*, that New Jersey's rights to the property of estate were governed by a settlement agreement that had been accepted by the state legislature. *Id.* The trustee then brought a petition asking the court to consider the trustee's objections in adjudicating the state's claim, to which the Attorney General responded with an assertion of sovereign immunity. *Id.* At 571. The Supreme Court held that the bankruptcy court had subject matter jurisdiction to consider the trustee's objections and adjudicate the claim accordingly. *Id.* at 573, 67 S.Ct. 467. It reasoned that "[w]hen the State becomes the actor and files a claim against the [debtor's estate] it waives any immunity which it otherwise might have had respecting the adjudication of the claim." *Id.* at 574, 67 S.Ct. 467.

Applying *Gardner* to this case, it is indisputable that the state of Connecticut waived its sovereign immunity when its agency, DRS, filed a proof of claim against Charter Oak's estate.[3] But that does not end the inquiry because *Gardner* does not define the scope of the waiver that is effected by a state's filing of a proof of claim. Unanswered by *Gardner* is whether such a filing waives immunity with respect to all claims against the state, whether it waives immunity with respect to only some claims and not others, or whether it just prevents the state from asserting its immunity in response to objections lodged against its claim (as in *Gardner* itself).

The Supreme Court has never had the occasion to address these questions left open by *Gardner*. Most circuits agree, however, that when a state files a proof of claim, it waives its immunity as to at least some counterclaims,

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[3] The question of whether this waiver extended beyond claims asserted against DRS to claims asserted against other state agencies (e.g., DSS) is addressed in Part II(b), infra.

specifically compulsory counterclaims. *See, e.g., Arecibo Cmty. Health Care, Inc. v. Puerto Rico,* 270 F.3d 17, 28 (1st Cir. 2001)(holding that the Eleventh Amendment permits assertion of compulsory counterclaims by debtor against state where state has filed a proof of claim); *Schulman v. California (In re Lazar),* 237 F.3d 967, 978 (9th Cir. 2001)(same); *Wyoming Dep't of Trans. v. Straight (In re Straight),* 143 F.3d 1387, 1391 (10th Cir. 1998)(same); *Schlossberg,* 119 F.3d at 1148 (same). *Cf. Jones v. Yorke* (*In re Friendship Med. Ctr., Ltd.*), 710 F.2d 1297, 1301 (7th Cir. 1983)(suggesting that, under the Eleventh Amendment, waiver by litigation in bankruptcy case extends only to compulsory counterclaims that are capped by a setoff limitation). Compulsory counterclaims are those that arise out of "the same transaction or occurrence" as the subject matter of the suit, *Fed. R. Civ. P. 13(a)*, and they are the very claims permitted by § 106(b). *See United States v. Nordic Vill., Inc.*, 503 U.S. 30, 34, 117 L. Ed. 2d 181, 112 S. Ct. 1011 (1992)(noting in dicta that the predecessor to § 106(b) waives the sovereign immunity of the United States with respect to "compulsory counterclaims to governmental claims").

These rulings, however, do not address the different question of whether the Eleventh Amendment permits courts to construe a state's proof of claim as a waiver of its immunity with respect to permissive counterclaims that are capped by a setoff limitation, as provided in § 106(c). *See id.* (noting in *dicta* that the predecessor to § 106(c) waives the sovereign immunity of the United States with respect to "permissive counterclaims to governmental claims capped by a setoff limitation"). Although the question has received relatively scant judicial attention, principles derived from Eleventh Amendment jurisprudence support the proposition that the scope of a state's waiver by litigation should extend to such claims.

First, and most important, the fairness and consistency concerns that undergird the waiver-by-litigation doctrine favor an approach that would allow a debtor to assert a claim that would reduce or eliminate its indebtedness to the state:

> An interpretation of the Eleventh Amendment that finds waiver in the litigation context rests upon the Amendment's presumed recognition of the judicial need to avoid inconsistency, anomaly, and unfairness, and not upon a State's actual preference or desire, which might, after all, favor selective use of "immunity" to achieve litigation advantages.

Lapides, 535 U.S. at 620. From an equitable standpoint, we can see no reason why a state that has filed a proof of claim in a bankruptcy case should be permitted to raise the immunity shield in response to permissive counterclaims brought by the debtor, at least where those counterclaims are capped by a setoff limitation, as they are under § 106(c).[4] The setoff limitation protects the state's coffers because the state will never be liable to pay anything. The best success the trustee can achieve under § 106(c) is to reduce to zero the debt the estate owes to Connecticut. A

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[4] We need not reach the question of whether the Eleventh Amendment actually requires a setoff cap in these circumstances. Congress plainly has the power to circumscribe the jurisdiction of the federal courts more narrowly than required by the Constitution. *See* Richard H. Fallon, Jr., et al., Hart & Wechsler's *The Federal Courts and the Federal System*, 319-30 (5th ed. 2003) (discussing Congress's power to limit the jurisdiction of the federal courts); *see also Seminole Tribe*, 517 U.S. at 54, 116 S.Ct. 1114 (discussing sovereign immunity in terms of the jurisdiction of the federal courts). And the trustee, conceding this point, has limited its demand against DSS under § 106(c) to the amount, if any, that the bankrupt estate owes the state.

contrary rule, on the other hand, would allow states that are creditors to reap benefits from filing proofs of claim in bankruptcy actions while permitting them to withhold the debts they owe to the estate, giving them a distinct and unfair advantage over other (non-state) creditors.

In effect, all that § 106(c) permits is the assertion by the trustee that the state's claim has already been paid, or partially paid. While it may well be contrary to the doctrine of state sovereign immunity to allow a debtor to assert permissive counterclaims that might result in an affirmative recovery from the state, when the state asserts a claim in federal court, its immunity does not protect against the assertion of counterclaims to the extent they would reduce or defeat the state's claim.

Second, once a state has voluntarily submitted itself to the court's jurisdiction by filing a proof of claim with a view to reaping financial benefit, there is no longer any danger that the state will be subjected to the "indignity" of being haled into court -- which is the primary concern of the Eleventh Amendment. *See Fed. Mar. Comm'n,* 535 U.S. at 760, 112 S.Ct. 1864 ("The preeminent purpose of state sovereign immunity is to accord States the dignity that is consistent with their status as sovereign entities."). These two considerations persuade us that the Eleventh Amendment permits the assertion by a debtor of permissive counterclaims that are capped by a setoff limitation against a state that has filed a proof of claim. Because this is the scope of the waiver set forth in § 106(c), we conclude that the provision passes constitutional muster.

We note that the only other circuit to have considered this issue has arrived at the opposite conclusion. Relying on Supreme Court precedent establishing that waivers of sovereign immunity are to be "narrowly construed," the Fourth Circuit has held that the Eleventh Amendment permits only compulsory counterclaims to be asserted against the state in these circumstances. *See*

Schlossberg, 119 F.3d at 1147-48. We are not convinced by the Fourth Circuit's reasoning. First, the waiver-by-litigation doctrine is driven not by the state's "actual preference or desire," which might weigh in favor of construing a waiver narrowly, but rather by the "need to avoid inconsistency, anomaly, and unfairness," which requires a general assessment of the equities associated with the state's participation in the bankruptcy litigation. *Lapides,* 535 U.S. at 620, 112 S. Ct. 1640. As discussed above, the balance of these equities favors a construction of the Eleventh Amendment that would permit a debtor to assert a permissive counterclaim capped by a setoff limitation against a state that has filed a proof of claim.

Second, the Supreme Court developed the "narrow construction" rule as a means of interpreting a state's "unequivocal expression" of waiver in state statutes, state constitutions, and the like. *Nordic Vill.,* 503 U.S. at 34, 112 S. Ct. at 1011 (holding that a government's "consent to be sued must be construed strictly in favor of the sovereign") (internal quotation marks omitted); *see, e.g., Port Auth. Trans-Hudson Corp. v. Feeney,* 495 U.S. 299, 305, 110 S.Ct. 1868, 109 L.Ed.2d 264 (1990)(construing state statutory consent-to-suit provisions); *Atascadero State Hosp. v. Scanlon,* 473 U.S. 234, 241, 105 S.Ct. 3142, 87 L.Ed.2d 171 (1985)(construing provision of state constitution). Because the "narrow construction" principle is a tool for construing a state's express waivers of immunity, it has little relevance in this context, where the waiver is effected not through the language a state has used, but through the actions it has taken during the course of litigation. *See Lapides,* 535 U.S. at 620, 122 S.Ct. at 1640 (recognizing distinction between two types of waiver); *see also* Siegel, *Waivers*, 52 Duke L.J. at 1187 (characterizing express waivers as "consents to suit" and conduct waivers as waivers "without consent").

In sum, we decline to adopt the Fourth Circuit's reasoning and hold that § 106(c) is a permissible codification of the waiver-by-litigation doctrine.

b. Application of § 106(c)

DSS argues that even if § 106(c) is constitutional, it does not apply to this case. The agency insists that any waiver effected by DRS cannot be ascribed to DSS, which (DSS argues) is a different "governmental unit" from DRS for purposes of § 106(c). We disagree.

Section 106(c) provides that "there shall be offset against a claim or interest of a governmental unit any claim against such governmental unit that is property of the estate." 11 U.S.C. § 106(c). DSS correctly points out that this sentence makes sense only if the "governmental unit" that asserts a claim against the bankrupt estate is the same ("such") governmental unit against which the estate seeks a setoff. The question, however, is what is meant by "governmental unit."

The Bankruptcy Code, rather unhelpfully, defines "governmental unit" to mean "United States; State; . . . department, agency, or instrumentality of the United States . . . [or] a State." 11 U.S.C. § 101(27). If "governmental unit," when applied to this context, is read to mean a state "agency," then § 106(c) would not apply here because DRS and DSS are separate agencies and therefore cannot be the same "governmental unit." If, on the other hand, "governmental unit" can be read to mean "State," then both DRS and DSS would be encompassed within the definition and § 106(c) would apply.

DSS argues that the definition's inclusion of both the "State" and, separately, an "agency" thereof reveals Congress's recognition that an agency "can and will act only for itself," and that, by extension, one agency's waiver will not strip other agencies of the same state of their immunity in a particular case. Further, DSS argues, a

construction of the statute that conflates "agency" with "State" and effectively merges the former into the latter renders the reference to "agency" in 11 U.S.C. § 101(27) useless surplusage. *See Duncan v. Walker,* 533 U.S. 167, 174, 121 S. Ct. 2120, 150 L.Ed.2d 251 (2001) (holding that "effect [must be given], if possible, to every clause and word of a statute") (internal quotation marks omitted); see also *William Ross, Inc. v. Biehn Constr., Inc. (In re William Ross, Inc.),* 199 B.R. 551, 556 (Bankr. W.D. Pa. 1996) (court could not "ignore" the fact that § 101(27) definition of "governmental unit" includes state agencies).

We do not find these arguments persuasive. First, the most that can be said of the definition set forth in § 101(27) is that it strives toward completeness; we think it a stretch to read it as an implicit recognition that state agencies are always independent. Second, DSS's surplusage argument assumes that "governmental unit" must be construed the same way -- *i.e.*, as either "State" or "agency" -- in every case. But no such absolute construction is mandated by the statute or otherwise required. Rather, we believe that in determining whether "governmental unit" should be read as "State" or "agency," the inquiry should focus on the relationship between the agencies and the state treasury. If that relationship reveals that the agencies act, in effect, as a unitary creditor for non-bankruptcy purposes, the agencies should be treated as such in the bankruptcy context as well.

This approach is supported by the interpretation given to "governmental unit" in other contexts. For example, where general setoff rights are concerned, *see* 11 U.S.C. § 553(a), courts, analogizing to the federal government's right to setoff outside of bankruptcy, *see Cherry Cotton Mills v. United States,* 327 U.S. 536, 105 Ct.Cl. 824, 66 S. Ct. 729, 90 L.Ed. 835 (1946)(recognizing federal government's right to interagency setoff); *Aetna Cas. & Sur. Co. v. LTV Steel Co. (In re Chateaugay Corp.),*

94 F.3d 772, 776, 778-9 (2d Cir. 1996)(holding that federal government agencies have a common law right to interagency setoff), treat agencies and departments of the federal government, "except those acting in some distinctive private capacity," as a single "governmental unit."[5] *Hal, Inc. v. United States (In re Hal, Inc.),* 122 F.3d 851, 853 (9th Cir. 1997)(internal quotation marks omitted); *see, e.g., Turner v. SBA (In re Turner),* 84 F.3d 1294, 1296-98 (10th Cir. 1996)(en banc); *United States v. Maxwell,* 157 F.3d 1099, 1102 (7th Cir. 1998); *In re Nuclear Imaging Sys., Inc.,* 260 B.R. 724, 733-34 (Bankr. E.D. Pa. 2000) (collecting cases). The Ninth Circuit has also used this approach in the § 106 context, holding that, with the exception of agencies "acting in some distinctive private capacity," the United States as a whole, not an agency thereof, is the relevant "governmental unit" for waiver purposes. *See, e.g., Doe v. United States (In re Doe),* 58 F.3d 494, 498 (9th Cir. 1995). The rationale behind Doe is that because the United States holds itself out as a unitary creditor when it exercises its right to effect interagency setoffs or assert priority for a debt, equity requires that it be treated as a unitary creditor for sovereign immunity purposes as well. *Id.* at 498.

In this case, DSS concedes that any judgment in favor of DRS will redound to the benefit of the Connecticut state treasury, that DSS is funded from that treasury, and that DRS has a right, pursuant to Connecticut law, to offset a taxpayer's debt to DRS against any amounts owed by other state agencies to the taxpayer. *See* Conn. Gen. Stat. § 12-39g(a). Thus, like the federal government, the state of Connecticut acts as a unitary creditor. *See Wallach v. New York State Dep't of Tax & Fin. (In re Bison Heating and*

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[5] Section 553(a) does not refer to "governmental unit," but rather to "creditor." However, "creditor" is defined in 11 U.S.C. § 101(10) to mean an "entity," and "entity," in turn, is defined to include "governmental unit," 11 U.S.C. § 101(15).

Equip., Inc.), 177 B.R. 785, 791 (Bankr. W.D.N.Y. 1995) ("The ability of New York State to apply offset for its own benefit inexorably requires a similar application when offset works to its detriment."); *see also Straight*, 143 F.3d at 1391 (holding that Wyoming is a unitary entity for purposes of § 106). Although we recognize that some state governments may operate differently than the federal government, we find no relevant distinctions here.

For the same reasons, we reject DSS's alternative argument that the Eleventh Amendment itself erects an independent bar against extending the waiver by one state agency to other agencies of the same state. At least where the two agencies in question act as a unitary creditor, fairness (the fundamental driving force behind the waiver-by-litigation doctrine, *see Lapides*, 535 U.S. at 620, 122 S.Ct. 1640) demands that a waiver by one be deemed to extend to the other. Thus, we hold that 11 U.S.C. § 106(c) properly identifies one set of circumstances in which a state waives its immunity through its conduct in bankruptcy litigation, and that the statutory criteria of § 106(c) have been satisfied in this case. Pursuant to § 106(c), the trustee may seek from DSS so much of the reimbursements it is owed as will offset the estate's debt to DRS for unpaid taxes.

CONCLUSION

Accordingly, we affirm the district court's decision that § 106(c) permits the trustee to seek up to $ 148,643.34 from DSS by way of offset of DRS's claim against the bankrupt estate in that amount.

UNITED STATES DISTRICT COURT
DISTRICT OF CONNECTICUT

IN RE CHARTER OAK ASSOCIATES	:	
Bankr. No. 91-23999 (AHWS)	:	
Bankr. Adversary No. 95-217	:	
STATE OF CONNECTICUT, DEPARTMENT OF SOCIAL SERVICES Defendant – Appellant,	:	Civil Action No. 3:97CV16 (AWT)
v.	:	
NEAL OSSEN, TRUSTEE Plaintiff-Appellee.	:	

MEMORANDUM OF DECISION

The appellee, who is the Trustee of the Chapter 7 Estate of Charter Oak Associates, Inc., filed an adversary proceeding against the State of Connecticut, Department of Social Services seeking to recover sums allegedly owed to the debtor for services that it had provided the Department of Social Services. The defendant moved to dismiss the adversary proceeding. The Bankruptcy court denied the motion, holding that it had jurisdiction to determine whether the trustee's claim against the Department of Social Services may be set off against the debt owed by the debtor to the State of Connecticut, Department of Revenue Services, which had filed a proof of claim in the debtor's case. For the reasons set forth herein, the court concludes

that the Bankruptcy Court properly concluded that it had jurisdiction.

I. Background

The debtor, Charter Oak Associates, Inc., was formerly licensed by the Connecticut Department of Mental Retardation to operate group homes for state-supported persons with mental disabilities. On June 30, 1991, the debtor ceased operations of all of its group home facilities. On December 5, 1991, the debtor filed a petition for relief under Chapter 7 of the United States Bankruptcy Code in the United States Bankruptcy Court for the District of Connecticut. On March 27, 1992, the Department of Revenue Services filed a proof of claim in the amount of $148,643.34, based on the debtor's alleged failure to pay Connecticut use taxes on certain of its purchases.

In 1992 and 1993, the Department of Social Services audited the debtor. It determined that, based on revised room and board rates, the debtor was entitled to an additional reimbursement of $224,309.29 for certain rental payments made while it operated the group homes.

In June 1995, the trustee commenced an adversary proceeding against the Department of Social Services for the recovery of that additional reimbursement. In May 1996, the trustee filed a second amended complaint seeking either an order of turnover or a judgment in the amount of $225,309.29. The trustee alleged that the debtor was entitled to that amount, as determined by the department's postpetition audits, and that the department had waived its sovereign immunity when another state agency, the Department of Revenue Services, filed a proof of claim in the bankruptcy proceeding. The defendant filed a motion to dismiss on the ground that it had not waived its sovereign immunity pursuant to 11 U.S.C. § 106 because it was a separate governmental unit from the Department of Revenue Services and thus, was not subject to the jurisdiction of the Bankruptcy Court. The Bankruptcy

Court denied the defendant's motion. It held that although § 106(a) did not confer jurisdiction over a non-consenting state, the defendant's sovereign immunity had been waived for purposes of §§ 106(b) and (c) by the Department of Revenue Service's filing of a proof of claim in the Bankruptcy Court because both departments are part of a single "governmental unit." The Bankruptcy Court then concluded that it did not have jurisdiction under § 106(b) because the "same transaction or occurrence" requirement had not been satisfied, but that it did have jurisdiction under § 106(c) to determine whether the plaintiff's claim against the Department of Social Services could be set off against its debt to the Department of Revenue Services because both agencies are part of a single "governmental unit" for purposes of § 106(c).

II. Standard of Review

A district court reviewing a bankruptcy court's findings of fact uses the clearly erroneous standard. *See* Fed. R. Bankr. P. 8013; *Shugrue v. Air Line Pilots Ass'n Int'l (In re Ionosphere Clubs Inc.)*, 922 F.2d 984, 988 (2d Cir. 1990). "A finding [of fact] is 'clearly erroneous' when although there is evidence to support it, the reviewing court on the entire evidence is left with the definite and firm conviction that a mistake has been committed." *United States v. United States Gypsum Co.*, 333 U.S. 364, 395 (1948). A district court reviews a bankruptcy court's conclusions of law *de novo*. *See Shugrue*, 922 F.2d at 988; *In re colony Hill Assoc.*, 111 F.3d 269, 273 (2d Cir. 1997). Application of the Bankruptcy Code presents a question of law to be reviewed *de novo*. *See Shugrue*, 922 F.2d at 988-989; *see also* 28 U.S.C.A. § 157(c)(1) (West Supp. 2002) ("[A]ny final order or judgment from [a bankruptcy court] shall be entered by the district judge after considering the bankruptcy judge's proposed findings and conclusions and after reviewing *de novo* those matters to which any party has time and specifically objected.").

III. Discussion

Title 11 of the United States Code, sections 106(b) and (c) provide that:

> (b) A governmental unit that has filed a proof of claim in the case is deemed to have waived sovereign immunity with respect to a claim against such governmental unit that is property of the estate and that arose out of the same transaction or occurrence out of which the claim of such governmental unit arose.
>
> (c) Notwithstanding any assertion of sovereign immunity by a governmental unit, there shall be offset against a claim or interest of a governmental unit any claim against such governmental unit that is property of the estate.

11 U.S.C.A. § 106(b) and (c) (West Supp. 2001). The Bankruptcy Code defines a "governmental unit" as follows:

> "governmental unit" means United States; State; Commonwealth; District; Territory; municipality; foreign state' department, agency, or instrumentality of the United States (but not a United States trustee while serving as a trustee in a case under this title), a State, a Commonwealth, a District, a Territory, a municipality, or a foreign state; or other foreign or domestic government;

11 U.S.C.A. §101(27) (West Supp.2001).

The Bankruptcy Court concluded that "all the publicly acting agencies of the state are a single governmental unit for purposes of Eleventh Amendment immunity and setoff under §§ 106(a) and (b)." *In re*

Charter Oak Assoc., 203 B.R. 17, 22 (Bankr. D. Conn. 1996). Its analysis was as follows:

> The court relies, in part, on the holdings of several appellate courts deciding the identical issue involving the United States. *See Doe v. United States*, 58 F.3d 494, 498 (9th Cir. 1995) ("[B]ecause it often seeks to be treated as a single unitary creditor under the offset provisions of 11 U.S.C. § 553 [footnote omitted] . . . [f]or purposes of waiver of sovereign immunity and setoff under 11 U.S.C. § 106, all agencies of the United States, except those acting in some distinctive private capacity, are a single governmental unit.") . . . *In re Turner*, 84 F.3d 1294, 1297-1298 (10th Cir. 1996) (same); *In re Hal, Inc.*, 196 B.R. 159, 165 (9th Cir. BAP 1996) ("[F]ederal agencies' relationships [are not] as that of corporate subsidiaries . . . the more appropriate analogy is that of separate departments within a single corporation. Just as a large corporation has different departments – marketing, sales, accounting, personnel, etc., with individual budgets and separate interests – so does the federal government. In both situations, each separate department must compete against the others for its share of the overall budget. Such is not necessarily the case with corporate subsidiaries, who are often expected to be self-sustaining and whose fortunes are not necessarily tied to the parent's profitability.").
>
> The court can conceive of no reason why the same analysis will not apply as well

> to the agencies of a state. The filing of the proof of claim by the defendant's Department of Revenue Services constitutes a waiver of the defendant and all its agencies to the extent set forth in §§ 106(b) and (c).

Id. at 22-33 (footnote omitted). Accordingly, the Bankruptcy Court held that it had jurisdiction to determine whether the debtor was entitled to set off against the Department of Revenue Service's claim against the debtor and the debtor's claim against the Department of Social Services based on the principle that the two claims were "mutual debts arising out of separate transactions." *Id.* at 24.

In its analysis, the Bankruptcy Court took note of the fact that courts have come to differing conclusions as to whether the publicly acting agencies of a state are a single "governmental unit" under § 101(27). Some courts have concluded that agencies are separate governmental units for purposes of waiving sovereign immunity under Section 106. *In re Exact Temp, Inc.*, 231 B.R. 566 (Bankr. D.N.J. 1999) analyzes the issue as follows:

> The term "governmental unit" is defined in Code section 101 . . .
>
> It is a fundamental principle of statutory construction that, absent any instruction otherwise, the same meaning must be attributed to a term repeatedly employed throughout a statute. Congress failed to indicate that the term "governmental unit" as used in the first clause of section 106(b) was to be interpreted more narrowly or more broadly than the identical term used in the successive clauses. Thus, it is illogical to suggest that the term means "state" in one clause of the subsection but means "agency" in the following clause. The trustee suggests

> that the court must construe section 106(b) to essentially say, "An 'agency' that has filed a proof of claim in the case is deemed to have waived sovereign immunity with respect to a claim against "the state" that is property of the estate and that arose out of the same transaction or occurrence out of which the claim of 'such agency' arose." The court declines to adopt such a construction. Statutory language should be given its plain meaning where possible, and in light of Code section 101(27) each agency is plainly a separate "governmental unit."

Id. at 571; *see also In re Wiliam Ross, Inc.*, 199 B.R. 551, 555-56 (Bankr. W.D. Pa. 1996) (based on "the plain language of the 11 U.S.C. § 101(27), which defines 'governmental unit,'" interagency offset is not permitted by §106(c)).

Other courts, however, have concluded that agencies of a state are part of a single "governmental unit." The court finds the analysis in two cases to be particularly helpful. The analysis in *In re Bison Heating & Equip., Inc.*, 177 B.R. 785 (Bankr. W.D.N.Y. 1995), is as follows:

> As used in section 106 of the Bankruptcy Code, "governmental unit" may certainly refer to subdivisions that are less comprehensive than one of the fifty states. . . The state, therefore, will determine [the subdivisions'] essences and will thereby define whether any such essence constitutes a separate governmental unit for purposes of the Bankruptcy Code. The sovereign may announce this separateness, or lack thereof, by implication or through outright declaration. Recognizing the ultimate authority of the state to empower its own

> subdivisions, this Court must honor [New York's] clear statement disaffirming a subdivision's separate identity.

Id. at 789. Also, the analysis in *In re Straight*, 143 F.3d 1387 (10th Cir. 1998), was that:

> Like most states, Wyoming acts through its departments and agencies. The Wyoming Supreme Court, for example, has noted a school district, as a creation of the state, cannot sue the state because "[o]ne cannot sue himself." *Carbon County Sch. Dist. No. 2 v. Wyoming State Hosp.*, 680 P.2d 773 (Wyo. 1984). In adopting the Wyoming Code of Civil Procedure, the state legislature, has made clear the state and its agencies are the same. *See* Wyo. Stat. § 1-39-(103)(a)(vi) (1998) ("'State' or 'state agency' means the state of Wyoming or any of its branches, agencies departments, boards, instrumentalities or institutions."). *See also Wyoming v. Board of County Comm'rs.* 642 P.2d 456, 457-58 (Wyo. 1982) (County, as agency of the state, cannot sue the state because it is "part of the state itself" and "[o]ne cannot sue himself.").

Id. at 1390-91.

The court is persuaded that the approach taken in *In re Bison* and *In re Straight* is the proper one. The question of whether the agencies of a state are separate "governmental units" under § 101(27) is to be determined based on the law of the state in question. This approach is consistent with the approach taken by courts that have concluded that publicly acting agencies of the United States are part of a single "governmental unit" under §101(72). *See Doe v. United States*, 58 F.3d 494, 498 (9th Cir. 1995)

("[T]he United States represents itself as ready to be considered as a single, unitary debtor.").

Therefore, in using the term "governmental unit" in the case of some states, their publicly acting agencies will be covered by the term "State" and thus constitute one governmental unit, while in the case of other states, their publicly acting agencies may be covered by the clause "department, agency or instrumentality of . . . a State" and thus constitute separate governmental units. The pivotal question, then, is what does Connecticut law provide.

There is no Connecticut law directly on point on this question. The appellant points to three cases in support of its position that, in Connecticut, state agencies are separate governmental units. In *Conn. Comm'n on Special Revenue v. Conn. Freedom of Info. Comm'n*, 174 Conn. 308 (1978), two state agencies were opposing parties in litigation. In *State v. Fritz*, 204 Conn. 156 (1987), the court held that the state's department of consumer protection and its division of criminal justice were not in privity with each other for purposes of collateral estoppel. Finally, in *Donis v. Conn. Bd. Of Examiners in Podiatry*, 207 Conn. 674 (1988), the court found that the Board of Examiners of Podiatry was an agency separate from the Department of Health Services for purposes of being a party of record to an administrative proceeding and that the plaintiff's failure to cite and serve the Department, as required by Conn. Gen. Stat. § 4-183(b), deprived the trial court of subject matter jurisdiction.

The court finds more persuasive two provisions of Connecticut law, which indicate that Connecticut's publicly acting departments and agencies are part of a single "governmental unit" under § 101(27). The subject matter of each of these two provisions of Connecticut law bears a closer relationship to the nature of the activities of the State of Connecticut that are at issue in this case than does the subject matter of any of the cases upon which the appellant

relies. Also, both of these provisions of Connecticut law were in effect at all times pertinent to this case.

First, Chapter 53 of the Connecticut General Statutes deals with claims against the State. *See* Conn. Gen. Stat. § 4-141 *et seq*. Section 4-141 sets forth certain definitions applicable to Chapter 53. Those definitions include the following:

> "Claim" means a petition for the payment or refund of money by the state or for permission to sue *the state*; "just claim" means a claim which in equity and justice *the state* should pay, provided *the state* has caused damage or injury or has received a benefit; . . . "state agency" includes every department, division, board, office, commission, arm, agency and institution of *the state government*, whatever its title or function, and "state officers and employees" includes every person elected or appointed to or employed in any office, position or post in *the state government* whatever his title, classification or function . . . .

Conn. Gen. Stat. § 4-141 (1996) (emphasis added). Thus, § 4-141 indicates that injuries are not caused by, and liabilities are not incurred by, departments or agencies of the State, but rather caused or incurred by the State.[1] Also, the statute indicates that departments and agencies are recognized as being part of "the state government."

The second pertinent provision of Connecticut law is Conn. Gen. Stat. § 12-39g, which provides as follows:

> (a) Upon notification to the Comptroller by the Commissioner of Revenue Services that

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[1] *See also* Conn. Gen. Stat. § 4-160 (judgment is entered against "the state").

> any taxes, including penalties and interest related thereto, are (1) *due to the state* from any person and unpaid and a period in excess of thirty days has elapsed following the date on which such taxes were due and (2) are not the subject of a timely filed administrative appeal to said commissioner or of a timely filed appeal pending before any court of competent jurisdiction, the Comptroller shall withhold any order upon the Treasurer for payment of *any amount payable by the state* to such person unless the amount so payable is reduced by the amount of such taxes, penalties and interest, provided any such amount payable by the state shall not be so reduced if such amount payable is a payment of salary or wages, or any payment in lieu of or in addition to such salary or wages, to a state employee. The Comptroller shall promptly notify the Commissioner of Revenue Services of any payment reduced under the provisions of this section.

Conn. Gen. Stat. § 12-39g(a)(West 1996)(emphasis added). Thus, under this statute, the State of Connecticut treats any amount payable by any department or agency of the State to a creditor as being subject to an offset equal to the amount of any taxes, including related penalties and interest, that are payable to the State by that creditor. Those taxes are collected by the Department of Revenue Services. The logical import of this statute is that the State of Connecticut acts as a unitary creditor.

For those reasons, the court concludes that the Bankruptcy Court's finding that all publicly acting agencies of the State of Connecticut are a single governmental unit for purposes of 11 U.S.C. § 106 was correct.

The appellant raises three additional arguments, namely, (i) that , even if Congress intended to provide in § 106(c) that the filing of a proof of claim by one state agency waives, to the extent provided in § 106(c), sovereign immunity for all agencies of the state, Congress did not express its intent to do so in unequivocal language, (ii) that the State of Connecticut did not consent to the Bankruptcy Court's jurisdiction by virtue of the filing of the proof of claim by the Department of Revenue Services, and (iii) if Congress in fact enacted a statute that provided for the result contemplated by the Bankruptcy Court's holding, then Congress acted in excess of its authority. The Bankruptcy Court covered all of these points in its memorandum of decision, setting forth the appropriate analysis. *See In re Charter Oak Assoc.*, 203 B.R. at 21-22.

Accordingly, after *de novo* review, this court agrees with the holdings of the Bankruptcy Court.

IV. Conclusion

For the reasons set forth above, the Bankruptcy Court's order denying the defendant's motion to dismiss is hereby AFFIRMED.

It is so ordered.

Dated this 30th day of September 2002 at Hartford, Connecticut.

Alvin W. Thompson
United States District Judge.

IN RE: CHARTER OAK ASSOCIATES, Debtor.

NEAL OSSEN, TRUSTEE, Plaintiff
v.
STATE OF CONNECTICUT, DEPARTMENT OF SOCIAL SERVICES, Defendant

Bankruptcy No. 91-23999.
Adversary No. 95-2175.

UNITED STATES BANKRUPTCY COURT,
D. CONNECTICUT

November 25, 1996

David H. Flynn, Rome McGuigan Sabanosh, P.C., Hartford, CT, for Plaintiff.

Edward F. Osswalt, Office of Attorney General, Hartford, CT, for Defendant.

MEMORANDUM OF DECISION AND ORDER ON DEFENDANT'S MOTION TO DISMISS SECOND AMENDED COMPLAINT

ROBERT L. KRECHEVSKY, Bankruptcy Judge

ISSUE

The defendant, State of Connecticut, Department of Social Services, has filed a motion to dismiss an adversary proceeding brought against it by the plaintiff, Neal Ossen, Trustee of the Chapter 7 Estate of Charter Oak Associates, Inc., the debtor. The parties have submitted the matter for ruling upon a stipulation of facts and law memoranda. The issue is the proper construction to be placed on the

provisions of Bankruptcy Code § 106[1], following the U.S. Supreme Court's decision in *Seminole Tribe of Florida v.*

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[1] 11 U.S.C. § 106. Waiver of sovereign immunity

(a) Notwithstanding an assertion of sovereign immunity, sovereign immunity is abrogated as to a governmental unit to the extent set forth in this section with respect to the following:

(1) Sections 105, 106, 107, 108, 303, 346, 362, 363, 364, 365, 366, 502, 503, 505, 506, 510, 522, 523, 524, 525, 542, 543, 544, 545, 546, 547, 548, 549, 550, 551, 552, 553, 722, 724, 726, 728, 744, 749, 764, 901, 922, 926, 928, 929, 944, 1107, 1141, 1142, 1143, 1146, 1201, 1203, 1205, 1206, 1227, 1231, 1301, 1303, 1305, and 1327 of this title.

(2) The court may hear and determine any issue arising with respect to the application of such sections to governmental units.

(3) The court may issue against a governmental unit an order, process, or judgment under such sections or the Federal Rules of Bankruptcy Procedure, including an order or judgment awarding a money recovery, but not including an award of punitive damages. Such order or judgment for costs or fees under this title or the Federal Rules of Bankruptcy Procedure against any governmental unit shall be consistent with the provisions and limitations of section 2412(d)(2)(A) of title 28.

(4) The enforcement of any such order, process, or judgment against any governmental unit shall be consistent with appropriate nonbankruptcy law applicable to such governmental unit and, in the case of a money judgment against the United States, shall be paid as if it is a judgment rendered by a district court of the United States.

(5) Nothing in this section shall create any substantive claim for relief or cause of action not otherwise existing under this title, the Federal Rules of Bankruptcy Procedure, or nonbankruptcy law.

(b) A governmental unit that has filed a proof of claim in the case is deemed to have waived sovereign immunity with respect to a claim against such governmental unit that is property of the estate and that arose out of the same transaction or occurrence out of which the claim of such governmental unit arose.

(c) Notwithstanding any assertion of sovereign immunity by a

Florida, ___ U.S. ___, 116 S.Ct. 1114, 134 L.Ed.2d 252 (1996)(hereinafter "Seminole Tribe"), as applied to the facts of this proceeding.

BACKGROUND

The debtor, the former operator of thirteen leased residential facilities as a licensed provider for the benefit of state-supported persons with mental disabilities, filed a petition requesting relief under Chapter 7 on December 31, 1991. The plaintiff, on May 16, 1996, filed a second amended complaint containing two counts against the defendant seeking either an order of turnover, or a judgment, in the amount of $ 225,309.29. In the first count, described as a core proceeding pursuant to 28 U.S.C. § 157 (b)(1)[2] and (b)(2)(A) and (E),[3] the plaintiff asserts that between November 12, 1987 and March 17, 1989, the debtor, under lease provisions with the non-profit corporate lessor, was reimbursed for its services by the defendant; that the defendant, after an audit of the debtor which the

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governmental unit, there shall be offset against a claim or interest of a governmental unit any claim against such governmental unit that is property of the estate.

11 U.S.C. § 106.

Bankruptcy Code § 101(27) defines "governmental unit" to mean "United States; State; Commonwealth; ...."

[2] Section 157(b)(1), permits the bankruptcy court to conduct hearings and to enter final judgments in core proceedings.

[3] Section 157 (b)(2)(A) and (E) provide:
(b)(2) Core proceedings include, but are not limited to--
(A) matters concerning the administration of the estate;
. . .
(E) orders to turn over property of the estate;
28 U.S.C. § 157(b)(2)(A) and (E).

defendant conducted postpetition, concluded that the debtor was entitled to an additional $ 225,309.29 from the defendant, that the defendant has refused to turn over such liquidated audit adjustment to the plaintiff; that the defendant, by its Department of Revenue Services, has filed a proof of claim in the debtor's case in the amount of $ 148,643.34; and that the plaintiff is entitled to the requested turnover pursuant to Bankruptcy Code § 542(b).[4] The plaintiff in the second count of the amended complaint makes essentially the same allegations, but, as an alternative to the first count, treats the cause of action as a non-core proceeding under 28 U.S.C. § 157(c)(1).[5]

The proof of claim filed by the Department of Revenue Services on March 27, 1992 is based upon the debtor's alleged failure to pay Connecticut use taxes on certain of its purchases. The stipulation of facts states that "the Connecticut use tax is a tax on the consumption, use or storage of certain items in Connecticut" on purchases which "relate to the debtor's operation of the Facilities";

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[4] Section 542(b) provides:

(b) ... an entity that owes a debt that is property of the estate and that is matured, payable on demand, or payable on order, shall pay such debt to, or on the order of, the trustee, except to the extent that such debt may be offset under section 553 of this title against a claim against the debtor.

11 U.S.C. § 542 (b).

[5] Section 157(c)(1) provides:

(c) (1) A bankruptcy judge may hear a proceeding that is not a core proceeding but that is otherwise related to a case under title 11. In such proceeding, the bankruptcy judge shall submit proposed findings of fact and conclusions of law to the district court, and any final order or judgment shall be entered by the district judge after considering the bankruptcy judge's proposed findings and conclusions and after reviewing de novo those matters to which any party has timely and specifically objected.

28 U.S.C. § 157 (c) (1).

and that the audit adjustment which the plaintiff claims the defendant has refused to pay "relates wholly to rent, property insurance and property taxes due the ... lessor of the group homes by the debtor," and not to the purchases allegedly subject to the use tax. Stipulation of Facts ¶¶ 3, 4, 5, 7.

After the defendant, on March 15, 1996, filed an initial motion to dismiss the original complaint, the Supreme Court, on March 27, 1996, decided Seminole Tribe. Reserving all arguments asserted in its initial motion and following a pre-trial conference and the filing by the plaintiff of the second amended complaint, the defendant filed the present motion to dismiss the second amended complaint. The defendant limits its contentions to: "the Court lacks jurisdiction to enter a money judgment against the defendant because the Eleventh Amendment precludes the exercise of such jurisdiction [] [in that] A. 11 U.S.C. § 106(a) which purports to abrogate State Sovereign Immunity is Unconstitutional as in excess of Congress' Authority . . .; and B. the defendant has not waived its Eleventh Amendment sovereign immunity either pursuant to 11 U.S.C. § 106(b) or under the common law . . . ." Motion to Dismiss dated July 15, 1996.

The plaintiff, in responsive papers to the defendant's motion, does not contest the defendant's claim that § 106(a) has been rendered unenforceable against a nonconsenting state by Seminole Tribe. He argues, however, that the court has federal jurisdiction to adjudicate the claim asserted against the defendant under §§ 106(b) and/or 106(c), and requests denial of the defendant's motion.[6]

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[6] In compliance with 28 U.S.C. § 2403 (a), the court advised the United States Attorney General that the constitutionality of 11 U.S.C. § 106 had been drawn in question in this proceeding. The United States has elected not to intervene.

DISCUSSION

I.

Section 106(a), As The Defendant Asserts And the Plaintiff Concedes, Has Been Rendered Unenforceable Against A Nonconsenting State By Seminole Tribe

The Eleventh Amendment provides: "The Judicial power of the United States shall not be construed to extend to any suit in law or equity, commenced or prosecuted against one of the United States by Citizens of another State, or by Citizens or Subjects of any Foreign State." The Supreme Court, in *Hans v. Louisiana*, 134 U.S. 1, 10 S.Ct. 504, 33 L.Ed. 842 (1890) judicially expanded the reach of the amendment to bar citizens from suing their own states in federal court.

Congress, in 1994, in response to the Supreme Court finding a lack of unequivocalness in a predecessor statute, *see Hoffman v. Connecticut Dep't of Income Maintenance*, 492 U.S. 96, 109 S.Ct. 2818, 106 L.Ed.2d 76 (1989), amended § 106 to abrogate the Eleventh Amendment as to the specific Bankruptcy Code provisions listed in § 106(a). Congress clearly relied on Art. I, § 8, cl. 4 of the U.S. Constitution, which empowers Congress "to establish ... uniform Laws on the subject of Bankruptcies throughout the United States", as the basis for this legislation.

In Pennsylvania v. Union Gas Co., 491 U.S. 1, 109 S.Ct. 2273, 105 L.Ed.2d 1 (1989), the Supreme Court had confirmed that Congress could abrogate a state's Eleventh Amendment immunity in the exercise of a Congressional power pursuant to the Commerce Clause contained in Article I. The Union Gas plurality reasoned that the states ceded their immunity to Congress when they agreed in adopting the Constitution to give Congress plenary

authority to regulate commerce. 491U.S. at 17-20. Seminole Tribe explicitly overruled Union Gas and denied to Congress the power so to act when Congress had legislated under the Interstate or Indian Commerce Clause of Article I. The Court ruled that Congress could not expand federal court jurisdiction under Article III through an exercise of Article I powers. Justice Rehnquist, writing for the majority in Seminole Tribe, and Justice Stevens, in dissent, both agreed that the Seminole Tribe ruling would have an impact on the enforcement of the Bankruptcy Code against states in federal courts, although they disagreed on the extent of the impact.[7]

To date, the majority of courts have ruled, and legal commentators have generally agreed, "that the Bankruptcy Clause in Article I does not authorize Congress to abrogate State sovereign immunity[8] and, specifically, that the Bankruptcy Clause did not authorize Congress to abrogate State sovereign immunity under 11 U.S.C. § 106(a)." *Sparkman v. State of Florida Department of Revenue* (*In re*

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[7] "JUSTICE STEVENS understands our opinion to prohibit federal jurisdiction over suits to enforce the bankruptcy, copyright, and antitrust laws against the States. He notes that federal jurisdiction over those statutory schemes is exclusive, and therefore concludes that there is 'no remedy' for state violations of those federal statutes. That conclusion is exaggerated both in its substance and in its significance." *Seminole Tribe* at ___n. 16, 116 S.Ct. at 1131-32 n. 16, majority opinion.

[8] "The term 'sovereign immunity' embraces two distinct concepts -- whether a State may be sued, or common-law sovereign immunity, and where a State may be sued, or constitutional sovereign immunity in the eleventh amendment. Thus, if a bankruptcy court can make determinations that bind a state under § 106 [], to that extent the state's eleventh amendment immunity from suit in federal court has been waived by § 106 []." *Hoffman v. Connecticut Department of Income Maintenance* (In re Willington Convalescent Home, Inc.) 850 F.2d 50, 56 n. 6 (2d Cir. 1988), *aff'd*, 492 U.S. 96, 109 S.Ct. 2818, 106 L.Ed.2d 76 (1989)(internal citations and quotation marks omitted).

York-Hannover Developments, Inc., 201 Bankr. 137, 141 (Bankr. E.D.N.C. 1996)(containing a current list of authorities). *See also* S. Elizabeth Gibson, *Sovereign Immunity in Bankruptcy, The Next Chapter* 70 Am. Bankr. L.J. 195, 216 (1996)("state governmental entities can no longer be sued in the bankruptcy court for any type of relief unless they give their consent to such proceedings."). The court concurs and concludes that § 106(a) cannot constitutionally confer federal jurisdiction to support the entry of a money judgment against the defendant, assuming for the purpose of this ruling that the plaintiff has properly asserted a core cause of action in the first count under § 542(b).[9]

II.

Federal Jurisdiction Obtained By Waiver Or Consent Through The Filing Of A Proof Of Claim

The significant issue that divides the parties is the effect of §§ 106(b) and (c) on the establishment of federal jurisdiction for the plaintiff's claim in light of the filing of a proof of claim by the defendant's Department of Revenue Services. Subsection (b) of § 106 provides that "[a] governmental unit that has filed a proof of claim in the case is deemed to have waived sovereign immunity with respect to a claim against such governmental unit that is property of the estate and that arose out of the same transaction or occurrence out of which the claim of such governmental unit arose." Subsection (c) provides "notwithstanding any

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[9] Under a motion to dismiss for lack of subject matter jurisdiction, the court accepts as true all material factual allegations in a complaint. *See Atlantic Mutual Ins. Co. v. Balfour Maclaine Int'l Ltd.*, 968 F.2d 196, 198 (2d Cir. 1992) Cf. *In re Willington Convalescent Home, Inc.*, 850 F.2d at 51 (trustee's action to recover concededly rendered estate Medicaid services to the state during Chapter 11 was "in essence, a turnover proceeding under § 542(b)" and not a "related" proceeding).

assertion of sovereign immunity by a governmental unit, there shall be offset against a claim or interest of a governmental unit any claim against such governmental unit that is property of the estate."

The two subsections, facially, do not conflict with the underpinnings of *Seminole Tribe*, and the court concludes that their provisions remain enforceable against states filing proofs of claim. As the defendant acknowledges: "The Supreme Court considered the effect of the filing of a proof of claim on a state's sovereign immunity defense in *Gardner v. New Jersey*, 329 U.S. 565, 67 S. Ct. 467 [,91 L. Ed. 504] (1947) . . . [and] concluded that immunity is waived to the extent necessary to adjudicate the claim made by the State. 'When the State becomes the actor and files a claim against the fund, it waives any immunity it might otherwise have had respecting the adjudication of the claim.' [329 U.S. at 574, 67 S. Ct. at 472]". *Defendant's Opening Memorandum* at 12-13 (emphasis omitted). Cf. *United States v. Nordic Village, Inc.*, 503 U.S. 30, 34, 112 S. Ct. 1011, 117 L. Ed. 2d 181 (1992)(The provisions of subdivisions (b) and (c) "plainly waive sovereign immunity with regard to monetary relief in two settings: compulsory counterclaims to governmental claims [subsection b] . . . and permissive counterclaims to governmental claims capped by a setoff limitation [subsection c].") (dicta); *In re 995 Fifth Avenue Associates L.P.*, 963 F.2d 503, 507 (2d Cir. 1992)("Waiver of Eleventh Amendment immunity, in contrast to abrogation, is not hinged to a specific federal statutory cause of action. Instead, it is triggered by some affirmative activity of a state, such as . . . a state's participation in litigation in federal court."); *WJM Inc. v. Mass. Dept. of Public Welfare*, 840 F.2d 996, 1003 (1st Cir. 1988), *abrogated on other grounds sub. nom. Reopell v. Comm. of Mass.*, 936 F.2d 12 (1st Cir. 1991), *cert. denied*, 502 U.S. 1004, 112 S. Ct. 637, 116 L.Ed.2d 655 (1991)(Section 106(b) "puts the state on notice that if it chooses to enter

the federal government's exclusive bankruptcy preserve by filing a claim, it must pay a price: a partial waiver of its sovereign immunity. . . . In short, because section 106[b] unambiguously alerts the states as to the consequence of filing a bankruptcy claim, we believe that a governmental unit that does so waives its sovereign immunity."). The defendant's argument that these subsections are "unconstitutional as in excess of Congress' authority" is not persuasive. *Defendant's Supplemental Memorandum* at 14.

The principal questions that remain, in line with the foregoing analysis, are: (1) whether the filing of a proof claim by the Department of Revenue Services waives only the immunity of that department and not that generally of the defendant or other state agencies; (2) whether the claim of the plaintiff and the proof of claim filed by the Department of Revenue Services arose out of the same transaction or occurrence; and (3) whether the debtor's estate may offset its claim against the defendant's claim for use taxes.

A. *The State Is A Single Entity*

The defendant argues "that the filing of the proof of claim by the Department of Revenue Services waives only the immunity of that department of state and not that of the defendant or other state agencies." *Defendant Supplemental Memorandum* at 10. The defendant relies upon bankruptcy court rulings such as *Unicore Homes, Inc. v. Four Seasons Care Centers, Inc. (In re Four Seasons Care Centers, Inc.)* 119 Bankr. 681, 683 (Bankr. D. Minn. 1990)("Certainly under 11 U.S.C. § 106 [b] and [c], the filing of a claim by one state department or agency does not ordinarily waive sovereign immunity as to others, or as to the state as a whole."). Other bankruptcy courts hold that the filing of a claim by one state agency constitutes a waiver for all state agencies. *See, e.g., Sacred Heart Hospital v. Pennsylvania* (*In re Sacred Heart Hospital*, 199 B.R. 1129, 135 (Bankr.

E.D. Pa. 1996)("The holdings ... that a claim filing by one state agency should constitute a waiver of eleventh amendment immunity rights for all state agencies is strengthened by the development of the principle that a governmental entity is generally considered as a unitary creditor for the purposes of setoff rights.").

The court concludes that all the publicly acting agencies of the state are a single governmental unit for purposes of Eleventh Amendment immunity and setoff under §§ 106(a) and (b). The court relies, in part, on the holdings of several appellate courts deciding the identical issue involving the United States. *See Doe v. United States*, 58 F.3d 494, 498 (9th Cir. 1995)("Because it often seeks to be treated as a single unitary creditor under the offset provisions of 11 U.S.C. § 553[10] . . . for purposes of waiver of sovereign immunity and setoff under 11 U.S.C. § 106, all agencies of the United States, except those acting in some distinctive private capacity, are a single governmental unit.") (footnote added); *In re Turner*, 84 F.3d 1294, 1297-98 (10 Cir. 1996) (same); *In re HAL, Inc.*, 196 Bankr. 159, 165 (9th Cir. BAP 1996)("Federal agencies' relationships [are not] as that of corporate subsidiaries . . . the more appropriate analogy is that of separate departments within a single corporation. Just as a large corporation has different departments -- marketing, sales, accounting, personnel, etc., with individual budgets and separate interests -- so does the federal government. In both situations, each separate department must compete against the others for its share of

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[10] Section 553. Setoff.

(a) ... this title does not affect any right of a creditor to offset a mutual debt owing by such creditor to the debtor that arose before the commencement of the case under this title against a claim of such creditor against the debtor that arose before the commencement of the case...

11 U.S.C. § 553 (a).

the overall budget. Such is not necessarily the case with corporate subsidiaries, who are often expected to be self-sustaining and whose fortunes are not necessarily tied to the parent's profitability.").

The court can conceive of no reason why the same analysis will not apply as well to the agencies of a state. The filing of the proof of claim by the defendant's Department of Revenue Services constitutes a waiver of the defendant and all its agencies to the extent set forth in §§ 106(b) and (c).

B. *The Plaintiff's Claim And The Defendant's Claim Do Not Arise Out Of The Same Transaction or Occurrence*

As noted, § 106(b) provides that the proof of claim is a waiver to a claim against such governmental unit that arose out of the same transaction or occurrence. This language tracks the language of Fed. R. Civ. P. 13(a), which defines a compulsory counterclaim as a claim which "arises out of the transaction or occurrence that is the subject matter of the opposing party's claim."

In defining the bounds of a compulsory counterclaim, the Second Circuit "generally has taken a broad view, not requiring an absolute identity of factual backgrounds . . . but only a logical relationship between them. . . . This approach looks to the logical relationship between the claim and the counterclaim and attempts to determine whether the essential facts of the various claims are so logically connected that considerations of judicial economy and fairness dictate that all the issues be resolved in one lawsuit." *United States v. Aquavella*, 615 F.2d 12, 22 (2d Cir. 1979)(internal citations and quotation marks omitted).

Applying this standard to the stipulation of facts submitted by the parties, the court concludes that the defendant's claim for use taxes due from the debtor is not so logically connected with the plaintiff's claim for reimbursement of services rendered the defendant that both issues would have to be resolved in one lawsuit. Like conclusions have been reached in several rulings dealing with generally comparable fact patterns. *See WJM, Inc. v. Massachusetts Dept. of Public Welfare*, 840 F.2d at 1003-1004 (debtor nursing home claim against state department of public welfare for medicare reimbursement did not arise out of same transaction or occurrence as the state department of revenue's back tax claim against debtor); *White v. Shalala* (*In re Pace Enterprises of Columbus, Inc.*), 171 Bankr. 444 (Bankr. D.D.C. 1994)(debtor's contract claim against U.S. Department of Health & Human Services did not arise out of same transaction or occurrence upon which claim for unpaid withholding taxes by IRS based); *Rocchio & Sons, Inc. v. State of Rhode Island* (*In re Rocchio & Sons, Inc.*), 165 Bankr. 86 (Bankr. D. R. I. 1994)(proof of claim filed by state taxing authority did not arise out of same transaction or occurrence as debtor's claim against department of transportation for turnover of funds owing under construction contracts).

The court, accordingly, does not acquire federal jurisdiction under § 106(b) because the plaintiff's claim for reimbursement for services does not arise out of the same transaction or occurrence giving rise to the defendant's claim for use taxes.

C. *The Plaintiff's Claim Qualifies As A Setoff To The Defendant's Proof Of Claim*

Section 106(c) authorizes setoff of a claim of an estate against a claim of a governmental unit. The Supreme Court, in *United States v. Nordic Village*, viewed this

section as waiving sovereign immunity in the setting of a permissive counterclaim to governmental claims capped by a setoff limitation. The Court, in *Citizens Bank of Maryland v. Strumpf*, ___U.S.___, 116 S. Ct. 286, 289, 133 L. Ed. 2d 258 (1995) commented upon setoff as follows: "the right of setoff (also called 'offset') allows entities that owe each other money to apply their mutual debts against each other, thereby avoiding 'the absurdity of making A pay B when B owes A.' Although no federal right of setoff is created by the Bankruptcy Code, 11 U.S.C. § 553 (a) provides that, with certain exceptions, whatever right of setoff otherwise exists is preserved in bankruptcy." (Citation omitted). *See also Newbery Corp. v. Fireman's Fund Ins. Co.*, 95 F.3d 1392, 1398 (9th Cir. 1996)("Setoff in bankruptcy cases is governed by 11 U.S.C. § 553 . . . Section 553 'is not an independent source of law governing setoff; it is generally understood as a legislative attempt to preserve the common law right of setoff arising out of non-bankruptcy law.'") (citations omitted).

The plaintiff's claim clearly qualifies as a setoff or a permissive counterclaim to the defendant's proof of claim. The plaintiff's claim and the defendant's claim are mutual debts arising out of separate transactions. The court concludes that the plaintiff's complaint, treated as an asserted setoff to the defendant's proof of claim, confers federal jurisdiction sufficient to deny the defendant's motion to dismiss. *See Wallach v. New York State Department of Taxation and Finance* (*In re Bison Heating & Equipment, Inc.*), 177 Bankr. 785 (Bankr. W.D.N.Y. 1995)(New York State treated as single entity and trustee may offset claim filed by New York State Department of Labor against trustee's claim for recovery from non-filing New York State Department of Taxation and Finance). Cf. *United States v. McPeck*, 910 F.2d 509, 512 (8th Cir. 1990) (where governmental unit's claim exceeds debtor's recovery from governmental unit, proper procedure is to offset

debtor's recovery against governmental unit's claim as § 106(c) causes waiver of sovereign immunity for such offset).

CONCLUSION

To summarize:

The court lacks federal jurisdiction to enter a money judgment against the defendant under § 106(a) because that statute relies upon an unconstitutional exercise of an Article I power to abrogate a state's Eleventh Amendment immunity.

The filing of a proof of claim by the defendant's Department of Revenue Services constitutes a waiver of Eleventh Amendment immunity rights for all defendant's agencies as the defendant-state is a single entity.

The court lacks federal jurisdiction to enter a money judgment against the defendant under § 106(b) because the claim of the plaintiff against the defendant and the proof of claim filed by the defendant do not arise out of the same transaction or occurrence.

The court does have federal jurisdiction under § 106(c) to determine whether the plaintiff's claim against the defendant may be set off against the proof of claim of the defendant filed by its Department of Revenue Services.

The motion to dismiss the complaint, for the foregoing reasons, must be, and hereby is, denied. It is

SO ORDERED.

Supreme Court, U.S.
FILED
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No. 03-1672

IN THE

Supreme Court of the United States

DEPARTMENT OF SOCIAL SERVICES,
STATE OF CONNECTICUT,

Petitioners,

v.

NEAL OSSEN, TRUSTEE,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF OF RESPONDENT

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QUESTIONS PRESENTED FOR REVIEW

Petitioner presents the following questions for review:

1. Whether, pursuant to 11 U.S.C. § 106(c), a state agency that files a proof of claim against a bankruptcy debtor can be deemed to waive its Eleventh Amendment immunity to a claim of setoff by the debtor when the claim of setoff does not arise out of the same transaction or occurrence as the agency's claim.

2. Whether, pursuant to 11 U.S.C. § 106(c), the filing of a proof of claim against a bankruptcy debtor by one state agency waives the Eleventh Amendment immunity of all state agencies.

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DECISIONS BELOW

The opinion of the court of appeals, Pet. App. 2a, is reported at 361 F.3d 760. The opinion of the district court, Pet. App. 21a, is unreported. The opinion of the bankruptcy court, Pet. App. 33a, is reported at 203 B.R. 17.

JURISDICTION

The court of appeals entered its judgment on March 19, 2004. Petitioner invokes the jurisdiction of this Court under 28 U.S.C. § 1254(1).

STATEMENT OF THE CASE

This matter arises out of the Chapter 7 bankruptcy case of Charter Oak Associates ("Charter Oak"), filed on December 31, 1991 (the "Petition Date"). Pet. App. 35a. Petitioner is the State of Connecticut, Department of Social Services ("DSS"). Respondent is Neal Ossen, chapter 7 trustee of Charter Oak's bankruptcy estate (the "Trustee").

The relevant facts are undisputed. Charter Oak formerly operated group homes for persons with mental disabilities. Pet. App. 35a. Pursuant to Conn. Gen. Stat. § 17a-228, Charter Oak received funding for its operations from the State of Connecticut (the "State"). After the Petition Date, DSS determined that the State owed Charter Oak $225,309.29 in withheld payments but refused to pay this money to Charter Oak. Pet. App. 35a-36a.

During the bankruptcy case, the State, acting through its Department of Revenue Services ("DRS"), filed a proof of claim against Charter Oak in the amount of $148,643.34,

alleging that Charter Oak failed to pay certain use taxes associated with its operation of the group homes. Pet. App. 3a.

On or about May 16, 1996, the Trustee filed a Second Amended Complaint (the "Complaint") in the bankruptcy court, seeking to recover the $225,309.29 that the State owed to Charter Oak. Pet. App. 35a. On or about July 15, 1996, the State moved to dismiss the Complaint on the ground that the bankruptcy court lacked jurisdiction to enter a money judgment against the State owing to the State's sovereign immunity.

First, the State argued that 11 U.S.C. § 106(a), which prescribes the abrogation of a State's sovereign immunity with respect to the application of certain provisions of the Bankruptcy Code, is unconstitutional. Pet. App. 37a. Second, the State argued that it had not waived its sovereign immunity by filing its proof of claim. *Id.*

In response, the Trustee did not contest the State's first assertion concerning section 106(a). Pet. App. 37a. With regard to the question of waiver, however, the Trustee argued that the bankruptcy court could proceed under sections 106(b) or 106(c). Section 106(b) provides, in pertinent part, that "[a] governmental unit that has filed a proof of claim . . . is deemed to have waived sovereign immunity with respect to a claim against such governmental unit . . . that arose out of the same transaction or occurrence out of which the claim of such governmental unit arose." 11 U.S.C. § 106(b). Section 106(c) provides that "[n]otwithstanding any assertion of sovereign immunity by a governmental unit, there shall be offset against a claim or interest of a governmental unit any claim against such governmental unit that is property of the [bankruptcy] estate." 11 U.S.C. § 106(c).

On November 25, 1996, the bankruptcy court concluded that it could not proceed under section 106(b) because the Trustee's claim against the State did not arise out of the same transaction or occurrence as the State's claim against the Trustee. Pet. App. 45a. Nevertheless, the court denied the State's motion to dismiss because the court concluded that it had jurisdiction to proceed under section 106(c) to determine whether the Trustee's claim against DSS could be offset against DRS's claim. The court reasoned that DRS's filing of its proof of claim waived the State's sovereign immunity for purposes of setoff. Pet. App. 47a. Specifically, the court determined that the Trustee's claim "clearly qualifies as a setoff or a permissive counterclaim to the defendant's proof of claim." Pet. App. 46a.

DSS appealed the decision to the district court. Pet. App. 23a-30a.[1] On September 30, 2002, the district court affirmed, holding that the bankruptcy court had jurisdiction under section 106(c) of the Bankruptcy Code to determine the setoff issue. Pet. App. 24a-32a.

On March 19, 2004, the court of appeals entered the decision below, affirming the district court's ruling that the Trustee could, consistent with the Eleventh Amendment and section 106(c) of the Bankruptcy Code, assert Charter Oak's claim against DSS to offset the State's tax claim against the bankruptcy estate. Pet. App. 17a-20a. The court of appeals expressly did not determine whether section 106(a) of the Code validly abrogates state sovereign immunity or whether the Trustee's claim meets the requirements of section 106(b). Pet. App. 5a-6a; Pet. App. 9a.

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1. As the Second Circuit noted in its decision below, the Trustee could not have appealed the bankruptcy court's rulings concerning sections 106(a) and 106(b), favoring the State's invocation of sovereign immunity, because these rulings were not immediately appealable. Pet. App. 6a n.2.

ARGUMENT IN SUPPORT OF GRANTING THE WRIT

The Trustee obviously views the merits of the questions presented differently than does the State. The Trustee nevertheless takes the position that the Court should grant certiorari in the instant matter because the question of the extent to which Eleventh Amendment immunity is waived, pursuant to section 106(c) of the Bankruptcy Code, when a state or state agency files a proof of claim is an important and recurring question as to which the courts of appeals have rendered conflicting decisions. *See* Supreme Court Rule 10(a). Certiorari also is warranted to resolve the important and recurring question whether a state agency's filing of a proof of claim waives the state's sovereign immunity with regard to the State and all its agencies — an issue over which the lower courts are divided. *See* Supreme Court Rule 10(a).[2]

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2. The issues in this case are not resolved or addressed by the Court's recent decision in *Tennessee Student Assistance Corp. v. Hood*, __ U.S. __, 124 S. Ct. 1905 (2004). In that case, the Court specifically noted that "Hood does not argue in this Court that TSAC waived its sovereign immunity, and we pass no judgment on the question." 124 S. Ct. at 1909 n.3. The issue resolved in *Hood* was whether a proceeding in bankruptcy to determine the dischargeability of a debt to a state ran afoul of the state's sovereign immunity. As the Court indicated in *Seminole Tribe of Fla. v. Florida*, 517 U.S. 44 (1996), the issue of a state's waiver of sovereign immunity is distinct from the question whether a state's sovereign immunity is offended by a particular type of proceeding in federal court. 517 U.S. at 65 (noting "the unremarkable, and completely unrelated, proposition that the States may waive their sovereign immunity").

A. Certiorari Should Be Granted To Resolve A Clear Circuit Split On The Important And Recurring Question Of The Scope Of The Waiver of Sovereign Immunity Under Section 106(c) Of The Bankruptcy Code.

The compelling need for this Court to resolve the question of the scope of the waiver of sovereign immunity under section 106(c) of the Bankruptcy Code is highlighted by the clear circuit split on this issue between the Second Circuit's decision in this case and the decision of the Fourth Circuit in *Schlossberg v. Maryland Comptroller of the Treasury (In re Creative Goldsmiths)*, 119 F.3d 1140 (4th Cir. 1997), *cert. denied*, 523 U.S. 1075 (1998).

The Second Circuit held in this case that "the Eleventh Amendment permits the assertion by a debtor of *permissive* counterclaims that are capped by a setoff limitation against a state that has filed a proof of claim." Pet. App. 15a (emphasis supplied). In contrast, the Fourth Circuit held in *Schlossberg* that a state waives Eleventh Amendment immunity in a state-instituted federal action only with respect to assertions that "amount to a *compulsory* counterclaim." 119 F.3d at 1148 (emphasis supplied). The Second Circuit recognized this split of authority, stating:

> We note that the only other circuit to have considered this issue has arrived at the opposite conclusion. Relying on Supreme Court precedent establishing that waivers of sovereign immunity are to be "narrowly construed," the Fourth Circuit has held that the Eleventh Amendment permits only *compulsory* counterclaims to be asserted against the state in these circumstances. . . .

> We are not convinced by the Fourth Circuit's reasoning. . . . In sum, we decline to adopt the Fourth Circuit's reasoning and we hold that § 106(c) is a permissible codification of the waiver-by-litigation doctrine.

Pet. App. 15a-16a.

The uncertainty surrounding the scope of the waiver of sovereign immunity under section 106 of the Bankruptcy Code is reflected in numerous decisions of the courts of appeal. *See Arecibo Cmty. Health Care, Inc. v. Puerto Rico*, 270 F.3d 17, 28 (1st Cir. 2001) (holding that the Bankruptcy Code validly waives a state's Eleventh Amendment immunity with respect to compulsory counterclaims, "even though they could require affirmative recovery from the state"), *cert. denied*, 537 U.S. 813 (2002); *Schulman v. California (In re Lazar)*, 237 F.3d 967, 977-78 (9th Cir. 2001) (stating that "the extent to which filing a proof of claim constitutes waiver of Eleventh Amendment immunity is uncertain" but holding that "when a state or an 'arm of the state' files a proof of claim in a bankruptcy proceeding, the state waives its Eleventh Amendment immunity with regard to the bankruptcy estate's claims that arise from the same transaction or occurrence as the state's claim") (internal quotation marks and citations omitted), *cert. denied*, 534 U.S. 992 (2001); *Rose v. United States Dep't of Educ. (In re Rose)*, 187 F.3d 926, 930 (8th Cir. 1999) (deciding that a state agency had waived its Eleventh Amendment immunity but declining to reach issues concerning "the constitutionality of the abrogation provision of § 106(a) and the statutory waiver provision of § 106(b)"); *Georgia Dep't of Revenue v. Headrick (In re Burke)*, 146 F.3d 1313, 1320 n.13 (11th Cir. 1998) (declining to "address whether the scope of the State's

waiver of Eleventh Amendment immunity extends to the full scope indicated by the Fourth Circuit in [*Schlossberg*]"), *cert. denied*, 527 U.S. 1043 (1999); *Wyoming Dep't of Trans. v. Straight (In re Straight)*, 143 F.3d 1387, 1390 (10th Cir. 1998) (holding that a state's Eleventh Amendment immunity is waived but only to permit a debtor to proceed against "claims asserted by the state that arose out of the same transaction or occurrence as a claim previously filed by the state in the bankruptcy estate"); *Jones v. Yorke (In re Friendship Med. Ctr., Ltd.)*, 710 F.2d 1297, 1301 (7th Cir. 1983) (limiting waiver of immunity to those matters "arising out of the same transaction or occurrence which is the subject matter of the suit," and declining to extend waiver to permissive counterclaims, i.e. "claims for affirmative relief in excess of or different in kind from that sought by the plaintiff").

The confusion concerning this issue is also evident in decisions of the district courts, bankruptcy appellate panels, and bankruptcy courts. *See Zayler v. United States*, 279 F. Supp. 2d 805, 811 (E.D. Tex. 2003) (holding that, in filing a proof of claim, a state waives sovereign immunity as to compulsory counterclaims arising out of the same transaction or occurrence under § 106(b)); *California Bd. of Equalization v. Harleston (In re Harleston)*, 275 B.R. 546, 550-51 (B.A.P. 9th Cir. 2002) (holding that, in filing a proof of claim, a state's waiver of immunity extends to ancillary claims that seek affirmative relief such that the debtor's adversary proceeding to determine dischargeability could proceed), *aff'd*, 331 F.3d 699 (9th Cir. 2003); *Grabscheid v. Michigan Employment Sec. Comm'n (In re C.J. Rogers, Inc.)*, 212 B.R. 265, 271-74 (E.D. Mich. 1997) (holding that waiver of sovereign immunity under § 106 constitutes an invalid abrogation of a state's Eleventh Amendment immunity and

restricting a state's waiver of its immunity in filing a proof of claim to "the adjudication of that particular claim"); *FSQ, Inc. v. Integrated Health Servs., Inc. (In re Integrated Health Servs., Inc.)*, 303 B.R. 577, 582-83 (Bankr. D. Del. 2003) (limiting waiver of sovereign immunity under § 106 to compulsory counterclaims that arose out of the same transaction or occurrence that are property of the estate and, thus, declining to extend waiver to include tortious interference claims asserted by a third party); *In re Microage Corp.* , 288 B.R. 842, 853-54 (Bankr. D. Ariz. 2003) (holding that a state waives immunity with respect to setoffs, pursuant to § 106(c), when it files a proof of claim); *Rose v. United States Dep't Educ. (In re Rose)*, 215 B.R. 755, 758 & 761-62 (Bankr. W.D. Mo. 1997), *aff'd in part and remanded by*, 227 B.R. 518 (W.D. Mo. 1998) (holding that, while it agreed with "the reasoning of the recent cases which have held that § 106(b) must be found to be unconstitutional to the extent it attempts to dictate the circumstances constituting a waiver of immunity on the part of a state," the state agency waived its Eleventh Amendment immunity as to the adjudication of the claims asserted in its proof of claim), *aff'd in part and remanded in part by*, 187 F.3d 926 (8th Cir. 1999).

It seems highly unlikely that the lower courts will resolve this conflict without the intervention of this Court. Moreover, this case presents an ideal vehicle for resolution of the issue. The question whether a state waives its sovereign immunity with respect to setoffs under section 106(c) of the Bankruptcy Code by filing a proof of claim is presented simply and clearly and is outcome determinative. If the Trustee is permitted to take his setoff, the setoff will reduce the State's claim against the bankruptcy estate and the State's ability to obtain distributions from the estate. In contrast, if the Trustee is not permitted to take his setoff, then the State's claim may not

be reduced and it may receive distributions on its claim. Moreover, the issue is one that arises frequently in the administration of bankruptcy proceedings. States often file proofs of claim and trustees often assert rights of setoff. Thus, resolution of the split of authority on the question presented is imperative to the efficient administration of bankruptcy cases.

In sum, the Court should grant certiorari in the instant matter to resolve a clear circuit split concerning the important and recurring question of the extent to which Eleventh Amendment immunity is waived under section 106(c) of the Bankruptcy Code when a state or state agency files a proof of claim in a bankruptcy case.

B. Certiorari Also Is Warranted To Resolve The Important And Recurring Question Whether A State Agency's Filing Of A Proof Of Claim Waives The State's Sovereign Immunity With Respect To The State And All Its Agencies.

Certiorari also is warranted to resolve the important and recurring question whether a state agency's filing of a proof of claim waives the state's sovereign immunity as to the state and all its agencies, a question left open by this Court's decision in *Gardner v. New Jersey*, 329 U.S. 565 (1947).

In *Gardner*, the Court held that, when a state files a proof of claim against a debtor's bankruptcy estate, "it waives any immunity it otherwise might have had respecting the adjudication of the claim." 329 U.S. at 574. As the Second Circuit noted in the decision below, however,

> [u]nanswered by *Gardner* is whether [filing a proof of claim] waives immunity with respect to

> all claims against the state, whether it waives immunity with respect to only some claims and not others, or whether it just prevents the state from asserting its immunity in response to objections lodged against its claim (as in *Gardner* itself).

See Pet. App. 12a (citing *Gardner*). *See also Schulman v. California (In re Lazar)*, 237 F.3d 967, 977 (9th Cir. 2001) (recognizing that "the extent to which filing a proof of claim constitutes waiver of Eleventh Amendment immunity is uncertain") (internal quotation marks and citations omitted); *Collier on Bankruptcy*, § 106.02[3][b] (Lawrence P. King, ed., 15th ed. rev. 2003) ("The Supreme Court has not yet clarified whether the state's waiver by filing a proof of claim extends [beyond its holding in *Gardner*], and the lower courts that have addressed the question have reached different conclusions.").

The Second Circuit held in the decision below that the State of Connecticut, like the federal government, acts as a "unitary creditor" for non-bankruptcy purposes and should be treated as such in bankruptcy as well. Pet. App. 18a-20a. Thus, when DRS filed its proof of claim on behalf of the State, it waived the State's sovereign immunity in connection with the Trustee's claim against DSS for purposes of setoff. Pet. App. 20a.

The Second Circuit's ruling on this point is supported by decisions of at least two other courts of appeals — the Ninth Circuit and the Tenth Circuit. *See Lazar v. California (In re Lazar)*, 237 F.3d 967, 979-80 (9th Cir. 2001) (holding that, because the California State Board of Equalization filed proofs of claims in the debtors' bankruptcy case that were

logically related to the Trustee's claims against the California State Water Resources Control Board ("State Board") in a mandamus adversary proceeding, the State Board had waived its Eleventh Amendment immunity in the mandamus adversary proceeding); *Doe v. United States (In re Doe)*, 58 F.3d 494, 498 (9th Cir. 1995) (holding "that as a matter of law, for purposes of waiver of sovereign immunity and setoff under 11 U.S.C. § 106, all agencies of the United States, except those acting in some distinctive private capacity, are a single governmental unit" and that should Doe prevail against the FBI on his tort claims, the IRS's claims against the bankruptcy estate may be reduced by the liquidated amount of Doe's tort judgment); *Straight v. Wyoming Dep't Transp. (In re Straight)*, 143 F.3d 1387, 1391 (10th Cir. 1998) ("We are convinced that the State of Wyoming is not an amalgam of separate, independent, and self-sustaining branches. Like the federal government, in bankruptcy it should be regarded as one unified entity with different arms through which it carries out the affairs of the state."). *See also In re Doctors Hosp. of Hyde Park, Inc.*, No. 02-3254, 2003 WL 21730747 (7th Cir. July 28, 2003) (allowing one state agency to deduct taxes owed by debtor from money that another state agency owned to assignee of debtor) (unpublished).

The Second Circuit's decision on this point also is supported by the decisions of at least five different bankruptcy courts. *See Wilson v. Georgia Dep't of Med. Assistance (In re Wilson)*, 259 B.R. 432, 438 (Bankr. S.D. Ga. 2000) (defining broadly a "governmental unit" so as to incorporate "all of the agencies acting on a state's behalf," and holding that "[i]n the case at bar, the Department of Medical Assistance and the Department of Revenue are agencies of the State of Georgia and clearly fall within the definition of

a governmental unit under Section 106(b)"); *Wallach v. New York State Dep't of Taxation & Fin. (In re Bison Heating & Equip., Inc.)*, 177 B.R. 785, 791 (Bankr. W.D.N.Y. 1995) (treating the New York State Department of Taxation and Finance and the New York State Department of Labor as a single entity for setoff purposes under section 106); *In re Downingtown Indus. & Agric. Sch.*, 172 B.R. 813, 822 (Bankr. E.D. Pa. 1994) ("[W]henever an agent or agency of a state files a proof of claim in a debtor's bankruptcy case, that agent or agency has waived the state's sovereign immunity."); *In re Hughes-Bechtol, Inc.*, 124 B.R. 1007, 1017 (Bankr. S.D. Ohio 1991) ("Defendants here have no viable Eleventh Amendment defense because at least one agency of the Commonwealth of Pennsylvania, i.e. , the Department of Revenue, has filed a proof of claim in this bankruptcy case. Eleventh Amendment immunity applies to the *states*, and through them to their agencies. A state may not selectively waive its immunity."); *In re Mason*, 79 B.R. 786, 788 (Bankr. N.D. Ill. 1987) (allowing state scholarship commission to assert a setoff right against the debtor's federal tax refunds, which had been turned over by the IRS to the state department of education).

Petitioner argues that the filing of a proof of claim by one state agency should not operate as a waiver of sovereign immunity as to other state agencies or the state as a whole and that, for purposes of § 106(c), each state agency should be considered a separate governmental unit, as that term is defined in 11 U.S.C. § 101(27). Pet. App. 17-18. In support of this argument, Petitioner cites one district court decision and three bankruptcy court decisions. Pet. App. 18 (collecting cases).

The question whether, by filing a proof of claim, one agency of a state waives the state's sovereign immunity with respect to the state and all its agencies is presented simply and clearly in this case and also is outcome determinative. Moreover, the issue is one that arises frequently in the administration of bankruptcy proceedings. Given the evident confusion of the lower courts, certiorari is warranted to review the Second Circuit's ruling on the important and recurring question whether a state agency's filing of a proof of claim waives the state's sovereign immunity as to the state and all its agencies.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be granted to review the decision of the court of appeals in this case.

Respectfully submitted,

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Supreme Court, U.S.
FILED
SEP 15 2004
OFFICE OF THE CLERK

IN THE

Supreme Court of the United States

DEPARTMENT OF SOCIAL SERVICES
OF THE STATE OF CONNECTICUT,

Petitioner,

—v.—

NEAL OSSEN, Trustee,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORAI FOR *AMICI CURIAE* PROFESSORS G. RAY WARNER, ROBERT M. ZINMAN, SUSAN BLOCK-LIEB, JONATHAN C. LIPSON AND TIMOTHY ZICK

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INTEREST OF THE *AMICI CURIAE*[1]

Amici Curiae are law professors who teach and write in the area of bankruptcy and constitutional law.[2] Their interest in this

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[1] Pursuant to Rule 37 of the Rules of the Supreme Court of the United States, the *Amici* file this brief with the written consent of all parties, which are appended hereto. No counsel for a party authored this brief in whole or in part. No person or entity including *Amici* or their counsel made a monetary contribution for the preparation or submission of this brief; it has been prepared *pro bono*.

[2] G. Ray Warner is a professor of law and Director of the Bankruptcy LL.M. Program at St. John's University School of Law. He has published numerous articles on bankruptcy and commercial law, and represented the bankruptcy trustee on the brief in *Fidelity Financial Services, Inc. v. Fink*, 522 U.S. 211 (1998), in which the Court ruled, 9-0, for the bankruptcy trustee. He is a founding Director of the American Board of Certification, a former Director of American Bankruptcy Institute, and a Fellow of the American College of Bankruptcy.

Robert M. Zinman is a professor of law at St. John's University School of Law, where he founded the LL.M. in Bankruptcy Program. He has written extensively on bankruptcy law and real estate law topics. He has served as President and Chairman of the Board of American Bankruptcy Institute and is both a Fellow of the American College of Bankruptcy and the American College of Real Estate Lawyers.

Susan Block-Lieb is a professor of law at Fordham Law School. She has written numerous articles on bankruptcy law subjects and is a Fellow of the American College of Bankruptcy.

Jonathan C. Lipson has been an associate professor of law at the University of Baltimore School of Law, and currently is Visiting Associate Professor of Law at Temple University – James E. Beasley School of Law. Professors Block-Lieb and Lipson were among the *amici* who filed a brief in support of the Petition for Writ of Certiorari in *Tennessee v. Hood*, 124 S.Ct. 1905 (2004), and who filed the *amicus* brief on the merits in that case which argued, successfully,

case lies solely in the expeditious, effective and fair administration of bankruptcy cases, and the efficiency and fairness of the bankruptcy system. They file this brief in support of the Petition for Writ of Certiorari, although they support the decision below, because this case poses an issue of vital importance, not only to states, but also to the bankruptcy bench and bar, which regularly deal with claims filed by states against trustees and debtors in bankruptcy cases and offsets that would reduce or eliminate such state-held claims. Over 1.5 million new bankruptcy cases were filed last year, and such filings continue at approximately the same rate this year. Because of the enormous volume of state-held claims in bankruptcy cases, it is extremely important for the Court to resolve the Circuit conflict that has developed on the issue of vital importance presented by this case.

DISCUSSION OF THE QUESTION PRESENTED

Petitioner, the Department of Social Services of the State of Connecticut (the "State"), has presented the issue as "whether, pursuant to 11 U.S.C. § 106(c), a state agency that files a proof of claim against a bankruptcy debtor can be deemed to waive its Eleventh Amendment immunity to a claim of setoff by the debtor when the claim of setoff does not arise out of the same transaction or occurrence as the agency's claim", and additionally, "whether, pursuant to 11 U.S.C. § 106(c), the filing of a proof of claim against a bankruptcy debtor by one state agency waives the Eleventh Amendment immunity of all state agencies".

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that the discharge in bankruptcy of state-held claims is an *in rem* adjudication that does not seek monetary damages or affirmative relief from a state, and thus does not constitute a suit against a state for purposes of the Eleventh Amendment.

Timothy Zick is a professor of law teaching constitutional law at St. John's University School of Law. His scholarly interests include federalism and the First Amendment, and his recent published articles focus on states' rights and state sovereign immunity.

The issues posed in the present case, as to the allowability of a setoff that seeks no monetary or other relief against a state, arise against the backdrop of the Court's decision earlier this year in *Tennessee Student Assistance Corp. v. Hood*, 124 S.Ct. 1905, holding that a bankruptcy court's exercise of its *in rem* jurisdiction to discharge state-held claims does not infringe state sovereignty, and specifically that "the discharge of a debt by a bankruptcy court is ... an *in rem* proceeding". *Id.* at 1910. In light of the theory of *Hood*, the question presented by this case in substance is whether the determination of an offset that would reduce or extinguish a state's claim asserted in its proof of claim, as authorized by 11 U.S.C. § 106(c), is an exercise of the bankruptcy court's *in rem* jurisdiction over the state-held claim and further, whether a state can invoke the jurisdiction of the bankruptcy court by filing a proof of claim and at the same time invoke the Eleventh Amendment to bar an offset that would reduce or eliminate its claim.

SUMMARY OF ARGUMENT

In light of the enormous volume of new bankruptcy cases filed each year, in many of which states file proofs of claim, it is important that the Court resolve the issue presented. We agree with the Petitioner that the question whether a claim asserted by a state in its proof of claim filed in a bankruptcy case can be reduced or eliminated by an offsetting claim of the bankruptcy trustee or debtor, is "an issue of vital importance". (Petition, p.9)

Circuit courts disagree on the issue. In the present case, the Second Circuit ruled against the State. In those jurisdictions in which the lower courts hold that states are immune from such setoffs, distributions to creditors may be delayed until the trustee's or debtor's claim against the state is resolved by a plenary action. In other cases, where distribution is made before the claim against a state is adjudicated in a plenary action, the debtor estate will have to pay the state on its claim and then bring suit in a state court to recover on the claim against the state. At that point, however, the trustee or debtor may be met with the state's

assertion of immunity from suit in its *own* courts. As a consequence, the debtor or trustee could be left without a remedy in any court if an offset is not allowed in the bankruptcy court. These consequences, which interfere with the expeditious administration of bankruptcy cases, can be avoided by sustaining the right to assert setoffs in the bankruptcy courts, as held by the Second Circuit below.

A long line of decisions by this Court supports the Respondent-trustee's position on the merits of the issue presented, culminating in the Court's decision in *Tennessee v. Hood*, 124 S.Ct. 1905 (2004) Under the theory of *Hood*, if a state has not been subjected to "coercive judicial process" and "choose[s] to participate" by filing a proof of claim, the adjudication of an offset would not be "an affront to States' sovereignty." *Id.* at 1911, 1913 & n.5. In adjudicating an offset, a bankruptcy court exercises its *in rem* jurisdiction and does not exercise personal jurisdiction over a state. Such an adjudication thus does not implicate the Eleventh Amendment.

It is vital that the issue be resolved by the Court. Certiorari should thus be granted.

ARGUMENT

There are millions of cases pending in American bankruptcy courts. States frequently file proofs of claim in bankruptcy cases. By filing proofs of claim they seek to participate in distributions of the assets of the debtor estate. Thus, the states voluntarily appear in thousands of bankruptcy cases to collect on their claims, but then, having invoked the jurisdiction of the bankruptcy courts, often plead that they have immunity from offsetting claims that would reduce or eliminate their own affirmative claims against the debtor estate.

Because an offset asserted pursuant to 11 U.S.C. § 106(c) seeks only to reduce or expunge the amount of the state-held claim asserted in its proof of claim, the bankruptcy trustee or debtor

"does not seek monetary damages or any affirmative relief from a State ... ; nor does [the debtor] subject an unwilling State to a coercive judicial process". *Tennessee v. Hood*, 124 S.Ct. at 1911-13 & n.5. Moreover, an offset by a debtor estate "is unlike an adversary proceeding by the bankruptcy trustee seeking to recover property in the hands of the State...", and adjudicating an offset is not "an affront to States' sovereignty." *Tennessee v. Hood*, 124 S.Ct. at 1913-14. In essence, where monetary damages and affirmative relief from a state are not sought and the state is not subjected to coercive judicial process, the bankruptcy court exercises *in rem* bankruptcy jurisdiction resulting from the filing of a proof of claim by a state, and the state accordingly does not have Eleventh Amendment immunity.

A state should not be allowed to escape from the consequences of invoking the jurisdiction of a bankruptcy court by filing a proof of claim. One of the consequences is that the bankruptcy trustee may seek to reduce the amount of the state-held claim or expunge it altogether by an offset of the debtor estate's claim against the claim of the state or any of its agencies. Even Petitioner recognized its amenability to such jurisdiction in its brief to the Court of Appeals for the Second Circuit, in which it stated (pp. 25-26):

> If a state agency elects to submit itself to the jurisdiction of a bankruptcy court by filing a proof of claim, it does so with the knowledge that the debtor may assert certain claims or setoffs against it. An individual state agency can make that judgment after weighing the rights, claims and defenses it has against the debtor and that the debtor has against it.

Indeed, Petitioner could not argue otherwise. Long ago, the Court, in *New York v. Irving Trust Co.*, 288 U.S. 329, 391 (1933), recognized that if a state chooses to participate in a bankruptcy proceeding, it will be subject to its broad powers, stating:

> If a state desires to participate in the assets of a bankrupt, she must submit to appropriate requirements by the controlling power; otherwise, orderly and expeditious proceedings would be impossible and a fundamental purpose of the Bankruptcy Act would be frustrated.

The Court likewise stated in *Alexander v. Hillman*, 296 U.S. 222, 242 (1935), that "by presenting their claims respondents subjected themselves to all the consequences that attach to an appearance," a proposition applied by the Court in defining the broad scope of the bankruptcy courts' jurisdiction in *Katchen v. Landy*, 382 U.S. 323, 335 (1966).

The right to assert a setoff is a "well-established common-law right of debtors ... to offset claims of their own against their creditors," *Gratiot v. U.S.*, 40 U.S. 336 (1841), and the Court has recognized "the absurdity of making A pay B when B owes A," *Studley v. Boylston Nat. Bank of Boston*, 229 U.S. 523, 528 (1913). Much more recently, in *Citizens Bank of Maryland v. Strumpf*, 516 U.S. 16, 18 (1995), the Court again remarked that it is necessary to allow an offset to avoid "the absurdity of making A pay B when B owes A."

In the present case, Petitioner contends that as a creditor it should be allowed to participate in distributions from the bankruptcy estate, and that the bankruptcy trustee's remedy, if any, is to bring a plenary action in a state court against the State to try to recover the money that the State owes to the debtor. There are, however, a number of serious implications and consequences to the "absurdity" of the position taken by Petitioner.

First, if the offset cannot be adjudicated in the bankruptcy court, the debtor's bankruptcy case cannot be closed and distributions to creditors may have to be delayed until the final outcome of the bankruptcy trustee's state court plenary lawsuit against the state based upon the debtor estate's claim against the state. This will impair the effective administration of bankruptcy

cases by increasing their cost and violate the principle that cases should be expeditiously conducted and concluded.

Second, unless an offset is allowed against a state's claim in the bankruptcy case, the bankruptcy trustee, acting on behalf of all creditors of the estate, may be left without any remedy at all to recover from the state on the claim of the debtor estate. As the Court held in *Alden v. Maine*, 527 U.S. 706, 712 (1999), Congress does not have the power under Article I of the United States Constitution "to subject nonconsenting States to private suits for damages in *state* courts." (Italics added.) In short, if a setoff is not allowed, states would be empowered to use the jurisdiction of the bankruptcy courts to collect on their own claims, while at the same time, defeating the availability of the very same courts, and possibly their own courts as well, to bankruptcy trustees and debtors to recover on their claims.

Petitioner's position fails to recognize the inequity of seeking to participate in distributions despite the existence of an offset that would preclude the State from participating in distributions made in the bankruptcy case. Such result would run counter to the Court's recognition that "courts of bankruptcy are essentially courts of equity, and their proceedings inherently proceedings in equity." *Local Loan Co. v. Hunt*, 292 U.S. 234, 240 (1934).

This case thus poses an issue of vital importance to the bankruptcy bench and bar, as well as to states. In light of the disagreement among Circuits, and disparate results reached in bankruptcy courts, this vital issue should be conclusively resolved by the Court. We agree with the Petitioner that the Court should "conclusively resolve this important and unsettled area of federal law [and that] certiorari is warranted." Petition, pp. 9-10.

CONCLUSION

For the foregoing reasons, the Petition for Writ of Certiorari should be granted.

Respectfully submitted,

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September 14, 2004